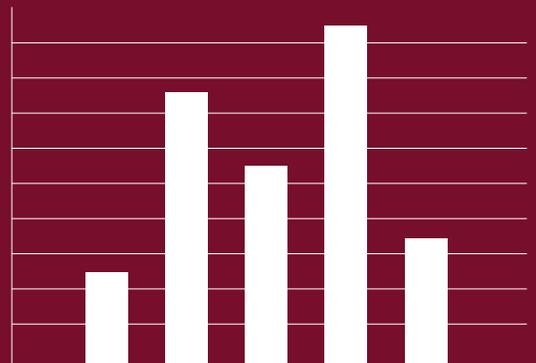


Funding Pensions & Retiree Health Care for Public Employees

A REPORT OF THE PUBLIC EMPLOYEE POST-EMPLOYMENT
BENEFITS COMMISSION



PUBLIC EMPLOYEE
POST-EMPLOYMENT BENEFITS
COMMISSION



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POST-EMPLOYMENT BENEFITS
COMMISSION

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Governor's Proclamation Creating the Commission Executive Order S-25-06

WHEREAS the State and other public entities within the State provide employees with pensions and other post-employment benefits such as health care; and

WHEREAS these benefits serve the public interest by attracting and retaining a workforce that protects the health and safety of the State; and

WHEREAS the most recent accounting reports from CalPERS and CalSTRS indicate that public employee pensions are underfunded; and

WHEREAS the Government Accounting Standards Board now requires the State and other public entities within the State to determine and report their liabilities for other post-employment benefits; and

WHEREAS only a small percentage of public entities have begun taking action to determine the full extent of their other post-employment benefits or to fund any liabilities that may exist in that regard, with the result that any such liabilities that may exist are largely unfunded; and

WHEREAS unfunded liabilities for other post-employment benefits are currently unknown, but the Legislative Analyst's Office estimates that they may be potentially tens of billions for the State and other public entities; and

WHEREAS the Legislative Analyst's Office has reported that elected officials throughout the State lack the information needed to develop strategies for addressing post-employment liabilities and urged more disclosure and planning in addressing this issue.

NOW, THEREFORE, I, ARNOLD SCHWARZENEGGER, Governor of the State of California, by virtue of the power and authority vested in me by the Constitution and statutes of the State of California, do hereby issue this Order to become effective immediately:

- 1 The Public Employee Post-Employment Benefits Commission (Commission) is hereby established. It shall consist of twelve members, six of whom shall be appointed by the Governor, three of whom shall be appointed by the Speaker of the Assembly, and three of whom shall be appointed by the Senate President pro Tem. The Governor shall designate one of the members as chairperson. The members of the Commission shall serve without compensation and at the pleasure of the official who appointed them.
- 2 On January 1, 2008, the Commission shall deliver a report to the Governor and to the Legislature that:
 - a Identifies, with regard to the State of California and its counties, cities, school districts, special districts, and any other affected government bodies, the amount and extent of unfunded liabilities for other post-employment benefits;
 - b Compares and evaluates the advantages and disadvantages of various approaches for addressing unfunded post-employment benefits; and
 - c Considers the advantages to the State from other post-employment benefits, such as providing retiree health care.
 - d Proposes a plan or plans for addressing unfunded post-employment benefits.
- 3 The Commission shall be disbanded 30 days after delivery of their report unless the Commission's service is extended by further Executive Order.
- 4 The Commission shall comply with applicable open meeting laws. This Executive Order is not intended to create, and does not create, any rights or benefits, whether substantive or procedural, or enforceable at law or in equity, against the State of California or its agencies, departments, entities, officers, employees, or any other person.
- 5 State departments and agencies shall cooperate and provide support to the Commission and local agencies are encouraged to provide support for the efforts of the Commission.

I FURTHER DIRECT that as soon as hereafter possible, this Order be filed in the Office of the Secretary of State and that widespread publicity and notice be given to this Order.

IN WITNESS WHEREOF I have hereunto set my hand and caused the Great Seal of the State of California to be affixed this 28th day of December 2006.



ARNOLD SCHWARZENEGGER
Governor of California



Message from the Chairman

Gerald L. Parsky

During the last 12 months, the Public Employee Post-Employment Benefits Commission (the Commission) met throughout the state and listened to nearly one hundred hours of testimony from concerned citizens, policy experts, and government officials. The Commission deliberated carefully about how best to fund post-employment benefits for our state's workforce. All of the information presented emphasized the importance to the State of California of both public employment and public employees.

It also became clear that the pension and health care components of compensation are critical to both active and retired public employees. It is devastating to individuals when health care benefits are changed after they have retired, since the cost of health services can easily deplete a retiree's income. The best way to ensure that government promises are kept is to provide prefunding for these benefits. It is equally important that this funding be made in a fiscally sound and prudent manner that will not negatively impact other government services.

Because of the volatility and unpredictability of health care costs, these benefits are just as important as are pension benefits to the state's workers and retirees. Certain health care benefits have become an integral component of retirement planning. Additionally, in many cases, these benefits are part of deferred compensation packages used to attract and retain qualified individuals for government service. The importance of these benefits in the eyes of workers and retirees cannot be overstated.

With respect to funding these critical benefits, it is important to emphasize that each public agency in California faces different funding constraints, personnel needs, and organizational purposes. A one-size-fits-all approach is neither appropriate nor practical. An understanding of that fact underlies both what the Commission addressed and what it did not. The Commission developed recommendations which are meant to facilitate compliance with the new reporting standards for OPEB benefits, to ensure the fiscal integrity of California's pension systems, and to hold all public agencies to a standard of best practices in finance, disclosure, deferred compensation structure, and budget priorities. The Commission did not pursue requests that it advocate statewide changes to retirement formulas and retirement age because those components of benefit design are bargained and determined at the local level.

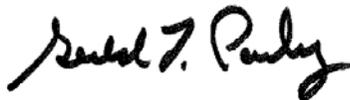
Early in our deliberations, the following three principles guided our discussions and recommendations:

1. A competitive, affordable benefits package serves the public good by enabling public employers to recruit and retain qualified public employees.
2. The costs of promised benefits should be fully identified, known, and paid for within the working career of those receiving the benefit. The processes for funding those benefits should be easily understood and actuarially sound.
3. In order to build awareness, support, and trust with taxpayers, including the employees of public agencies, the process through which benefits are adopted, modified, and/or paid for needs to be open, transparent, and defensible.

Consistent with the spirit in which this body was created by California's Republican and Democratic leaders, this bi-partisan Commission worked through differences to find common ground and reach consensus on solutions that, if followed, will benefit the state's fiscal health and promote the long-term well-being of its workforce.

Finally, we would like to commend the Governor and the Legislative Leaders for taking action on this vitally important issue for California. We especially appreciate the cooperative spirit in which they appointed a bi-partisan Commission. We are happy to report that the tone they set has continued throughout this last year. Personally, I have truly been impressed with the way in which each of the members represented their views and demonstrated a genuine desire to understand the views of others and reach common ground. It is with this spirit of bi-partisanship, cooperation, and desire to do what is right for California and its workforce that we unanimously present the following recommendations.

Sincerely,

A handwritten signature in black ink that reads "Gerald L. Parsky". The signature is written in a cursive, flowing style.

Gerald L. Parsky
Chairman
Public Employee Post-Employment Benefits Commission

Executive Summary

A Plan to Address Pension and OPEB Obligations

This report presents a plan to address public pension and retiree health care funding issues across the state of California. The following recommendations are divided into eight groups which together constitute a plan for addressing pension and Other

Post-Employment Benefits (OPEB) obligations. For more information on the background and rationale for each recommendation, please see the Recommendations section of this report.

Group 1

Identify and Prefund Financial Obligations

Recommendation 1

Public agencies providing OPEB benefits should adopt prefunding as their policy. As a policy, prefunding OPEB benefits is just as important as prefunding pensions. The ultimate goal of a prefunding policy should be to achieve full funding.

Recommendation 2

Each public employer shall identify its OPEB liability, adopt a prefunding plan, and make it public. If a public employer does not establish a prefunding plan, it shall clearly identify an alternative approach for addressing its OPEB liabilities and make public its reason for not prefunding.

Recommendation 3

The State of California shall establish prefunding as both a policy and budget priority, develop and make public a prefunding plan, and begin prefunding its OPEB liabilities.

Recommendation 4

Any employer considering the use of OPEB bonds should fully understand, and make public, the potential risks they bring. Such risks include: shifting costs to future generations, converting a future estimated OPEB liability into fixed indebtedness, and the uncertainty concerning continued federal cost sharing for debt service on such a bond.

Group 2 Limit Contribution Volatility and Use Smoothing Methods Judiciously

Recommendation 5

Public retirement systems which consider contribution rate volatility to be a problem should consider the use of longer asset smoothing periods to lessen that volatility.

Recommendation 6

A retirement system which has adopted an asset smoothing method should resist efforts to alter that method for short-term gain, including, but not limited to, contribution rate reductions and benefit increases.

Recommendation 7

Generally, employer contributions should not fall to zero. An employer should be permitted to have a full or partial contribution holiday only when its retirement plan is substantially overfunded. As used here, “substantially overfunded” means that the existing surplus is used to pay for all or part of the normal cost only after that surplus is amortized over a 30 year period, the longest amortization period allowed by GASB. In particular, employer contributions should fall to zero (“full contribution holiday”) only in the rare situation that the surplus is so great that it could be expected to fund a full 30 years of normal costs.

Recommendation 8

An employer whose pension account is overfunded and who has an OPEB liability should, as its first priority, use that surplus to address its OPEB liability. This should be done either by (1) transferring such surplus directly to OPEB funding in a manner which complies with federal and state law, or (2) using the budgetary savings from any contribution holiday (determined in accordance with Recommendation 7) to make additional contributions to OPEB funding.

Group 3 Increase Transparency and Accountability

Recommendation 9

Legislation should be enacted directing the State Controller’s Office to develop a simple and inexpensive procedure to regularly collect and report OPEB data from California public agencies. In order to minimize reporting requirements for public agencies, all the data collected for this report should be contained in the GASB 45 actuarial valuation report periodically required of each public agency and in the agency’s GASB 45 footnote. Reporting should be mandatory for those agencies which provide OPEB benefits.

Recommendation 10

The State Controller’s Office should publish the annual report of public pensions, which is required by current law, within 12 months of the receipt of data but in no case longer than 18 months after the end of the fiscal year.

Recommendation 11

With the exception of school districts and county offices of education, legislation should be enacted to amend Government Code Section 7507 to provide for more clarity in its cost reporting requirements and for clear accountability within a public agency adopting new benefit levels. Specifically, where that section now calls for the determination of “future annual costs”, it should be clarified to include “normal cost and any additional accrued liability”. Concerning increased accountability, language should be added which requires that the person holding the position with the responsibilities of a chief executive officer within the affected agency acknowledge in writing the actuary’s cost determination for the new benefit. School districts and county offices of education shall comply with disclosure requirements pursuant to AB1200 (Chapter 1213, Statutes of 1991) and AB 2756 (Chapter 52, Statutes of 2004).

Recommendation 12

With the exception of school districts and county offices of education, legislation should be enacted to amend Government Code Section 7507 so that it also applies to the granting or changing of OPEB benefits. As with pension benefits, this statutory change would require that the future costs of the proposed benefit change be determined by an actuary and be made public at least two weeks prior to adoption. School districts and county offices of education shall comply with disclosure requirements pursuant to AB1200 (Chapter 1213, Statutes of 1991) and AB 2756 (Chapter 52, Statutes of 2004).

Recommendation 13

With the exception of school districts and county offices of education, legislation should be enacted to amend Government Code Section 7507 to require that pension and/or OPEB benefit changes be subject to the public notice requirements found in that section and be presented with an actuary available to answer any questions or to provide additional information, as needed. The presentation and report should be in language easily understood by the layperson, and such information should not be placed on the consent calendar. School districts and county offices of education shall comply with disclosure requirements pursuant to AB1200 (Chapter 1213, Statutes of 1991) and AB 2756 (Chapter 52, Statutes of 2004).

Group 4 Improve Plan Design and Communication with Employees

Recommendation 14

An employer making a contribution to retiree health care should make that contribution proportionate to the number of years of employment and should reward longer careers. This recommendation should be implemented through collective bargaining and should be applied to newly hired employees. The use of proportionate credit to earn the employer contribution for retiree health care should apply only to service retirement.

Recommendation 15

An employer providing retiree health care should make that benefit dependent upon the employee retiring within a set time after separation from the job.

Recommendation 16

Public sector employers should provide tax-advantaged supplemental savings plans (e.g. 457, 401(k), 403(b), etc.) to their employees on an “opt out” basis. Public employers and their employees should jointly determine the details of any plan offered, including: whether to use a “hard” or “soft” opt out, the minimum contribution amount, and any default investment selection for employee contributions. Employers should also develop an ongoing program to educate employees about their savings options.

Recommendation 17

Public employers should provide regular explanations to their employees concerning the advantages of their defined benefit (pension and OPEB) plans, the role of compounded interest in their personal savings programs, and the advantage of contributing to savings on a pre-tax basis. Employees who participate in Social Security should be educated that this is a supplemental program only and not a retirement plan. This information should be communicated at regular intervals throughout an employee’s career.

Recommendation 18

Public employers should provide clear explanations to employees concerning current eligibility rules for retiree health care and the terms under which retiree health care is earned. Employers should also clearly explain to their employees the conditions under which health benefits for retirees are to be funded and paid. This information should be communicated at regular intervals throughout an employee’s career and through plan documents and collective bargaining agreements.

Recommendation 19

Public employers should provide timely notification to both active and retired employees when proposing a change in retiree health care benefits. This notification should be provided in a time frame that reasonably allows affected employees and retirees to understand the impact of the benefit change, to review other options available to them, and to comment to the employer on the proposed changes.

Recommendation 20

CalPERS should periodically inform its contracting agencies about the option of allowing permanent part-time employees access to the PEMHCA health care system. The amount of the employer contribution, if any, should be collectively bargained.

Group 5 Provide Independent Analysis

Group 6 Strengthen Governance and Enhance Transparency

Recommendation 21

Public employers should evaluate participation in alternate arrangements, including joint power authorities (JPA) and regional health care risk pools, as a means of providing retirees with access to health care coverage.

Recommendation 22

Legislation should be enacted to create a California actuarial advisory panel at the state level. The purpose of the advisory panel would be to provide the California Legislature, the Governor's office, public retirement systems, public agencies, and other interested parties with impartial and independent information on pensions, OPEB benefits, and best practices.

Such a panel would encourage greater transparency and understanding of actuarial methodology and assumptions used by public retirement systems and would gather and provide information concerning best actuarial practices. Individuals appointed to the advisory panel should have the requisite technical and educational skills to carry out their duties.

Recommendation 23

All public pension plans should have periodic performance audits performed by an independent auditor.

Recommendation 24

A retirement board should not provide incentives for an employer to enhance benefits, and benefit improvements by the employer should not be contingent upon a quid pro quo by the retirement board.

Recommendation 25

Retirement systems and public agencies should be open and transparent concerning the elements included in final compensation. All public retirement systems in California should have in place safeguards against pension spiking.

Recommendation 26

Legislation should be enacted which would do the following:

1. Make it a crime to make a fraudulent claim for a retirement or disability benefit or to keep a payment made on the basis of a fraudulent claim;
2. Require that workers' compensation insurers and the Director of EDD provide CalPERS investigators with information they deem necessary when investigating someone concerning the application for, or the receipt of, CalPERS benefits.

Recommendation 27

The granting of a disability retirement should be based solely on medical information and should not consider personnel, disciplinary, or other ancillary issues.

Recommendation 28

Boards overseeing pension or OPEB trust funds should evaluate not only reported actuarial liabilities and assets but also the underlying assumptions including discount rates, investment returns, mortality, health care inflation, and whether plans are open or closed systems. Boards should understand the sensitivity to changes in these assumptions, as well as the difference between actuarial values and market values. The authorities responsible for appointing members to public retirement boards should seek out individuals with expertise in the areas of public finance, investments, and public administration. In addition, the trustees of public retirement systems, as well as the trustees of OPEB trusts, should receive continuous training related to the understanding and fulfillment of their fiduciary responsibilities, actuarial methodology and assumptions, and conflict of interest requirements.

Recommendation 29

Boards which govern pension and/or OPEB trusts should have very strong conflict of interest policies and should adhere to those policies. All trustees should annually attest in writing that they understand and are in compliance with the conflict of interest policy.

Recommendation 30

Boards overseeing pension and/or OPEB trust funds should meet or exceed the transparency governance requirements they place on companies or on investment managers of plan assets.

Recommendation 31

Public retirement boards of trustees should establish a separate audit committee, made up of trustees, to oversee and participate in the opening, processing, and closing of the annual audit report to the full board.

Recommendation 32

Health plan sponsors should identify individuals who are Medicare-eligible and inform them of the need to enroll in Medicare in a timely manner. Employers should provide those individuals with information on penalties which result from delayed enrollment in Medicare.

Recommendation 33

Employers should provide incentives to individuals to enroll in Medicare and possibly a Medicare supplement plan once they become eligible for Medicare.

Group 7 Coordinate with Medicare

Group 8 Advocate Federal Tax Law Changes

Recommendation 34

At the request of numerous local agencies, the Commission agreed to consider several proposed tax changes. Because the Commission can play a unique role in communicating these issues to the IRS, the Commission will write a letter to the IRS recommending the following:

- **Investment of Assets Used to Fund Retiree Health Benefits:** The IRS should modify Revenue Ruling 81-100 to allow the commingling for investment purposes of the funds held to pay public employee OPEB obligations with retirement system funds, subject to appropriate safeguards. Those safeguards should require that OPEB funds must be held in trust solely for the benefit of retirees and beneficiaries and that investments and income must be properly accounted for and allocated.
- **Collectively Bargained Retiree Health Benefits:** The IRS should interpret the law in the same manner for retiree health benefits as it does for pensions, and not tax health benefits which are collectively bargained, even if they are not fully insured. The IRS also should not tax retiree health benefits that provide higher premium subsidies to retirees with longer service, whether or not those benefits are collectively bargained.
- **Saving For Retirement: Redeposits and Service Purchase:** The IRS should not change its current rules concerning pick ups and should not change its rules allowing pre-tax redeposits and the pre-tax purchase of service credit, particularly since there has been no change in the governing law.
- **Definition of “Government Agency” for Retirement Systems:** The IRS, DOL, and PBGC should open their process for defining “government agency” by holding public hearings and inviting government agencies and retirement systems to participate in these sessions to provide critical information before any decisions are made which could adversely affect many public employees.
- **Health Benefits: Retirees, Step Children, Domestic Partners, and All Others Covered by the Retiree Health Plan:** The IRS should not tax the health care benefits provided to everyone covered by a health care plan simply because the plan provides coverage for retirees’ step children and domestic partners who are not tax dependents of the retirees.

Summary of Retirement System Survey

On December 28, 2006, Governor Arnold Schwarzenegger established, by Executive Order S-25-06, the Public Employee Post-Employment Benefits Commission to address unfunded post-employment benefits. In order to identify the amount of pension benefits that remain unfunded, the Commission requested that the California Research Bureau (CRB) conduct a survey of the state's public retirement systems.

The purpose of the California Research Bureau Public Retirement System Survey was to determine the funding progress of California's defined benefit retirement systems by examining how pension plan assets compare with liabilities (the pension benefits that the retirement system is obligated to pay). Key findings from the survey include the following:

- California's public retirement systems reported a combined unfunded liability of \$63.5 billion as of their most recent actuarial valuations (2006 for most systems).
- The survey found an aggregate funded ratio of 89% for all of California's public retirement systems combined. This is lower than the peak of 118% reached in 2000, but higher than in the early- to mid-1990s.
- Even though State pension contributions have risen in the past decade, they have remained at a relatively stable 3.5% to 4% of total General Fund revenues from the mid-1990s to present. The exception is 1999 to 2002 when contributions were significantly lowered.

- While survey respondents report that pension contribution rates have generally risen from 1990 to the present, recent investment gains may cause rates to fall in the near future.

Survey Methodology and Key Concepts

Survey Respondents

The survey was conducted in May and June of 2007. An electronic questionnaire was sent to all of the state's defined benefit retirement systems. The California State Controller's Office lists 85 defined benefit pension systems in its most recent annual report on public employee retirement systems. These include:

- The Public Employees' Retirement Fund (PERF) administered by CalPERS for state, public agency, and classified school employees
- The Legislators' (for legislators serving prior to November 7, 1990) and Judges' Retirement Systems, also administered by CalPERS
- CalSTRS administers a plan for public K-12 and community college teachers
- The University of California Retirement System for University of California employees
- 20 systems operating under the County Employees' Retirement Law of 1937 and 2 independent county systems (the remaining 36 counties contract with CalPERS to provide pension benefits)

- 32 cities operate city retirement systems rather than providing pension benefits through CalPERS
- 25 special district systems operate their own retirement systems rather than providing pension benefits through CalPERS
- One school district system

Fifty-seven retirement systems (or about two-thirds) responded including all of the state and county retirement systems and all of the large city and special districts.¹ These 57 systems accounted for approximately 99% of all public pension system members and 99% of pension system liabilities at the end of fiscal year 2004/05, the most recent year covered by the State Controller’s Office annual report on public retirement systems. The systems that did not respond tended to be the smaller systems with a median of 349 members, compared to the systems that did respond whose median membership was 5,576.

Timeliness of the Data

The survey asked retirement systems to report data from their actuarial valuations. These valuations typically lag by one year. A valuation completed in June 2007, for example, includes data on the retirement system’s experience during the fiscal year that ended in 2006. The survey asked for retirement systems’ “most current” actuarial data, which in most cases was as of June 2006. Four retirement systems indicated that the data they provided was from 2005.

Pension Plan Funding Progress

Defined benefit retirement system funds are typically held in some form of trust that can only be used to pay member benefits and the costs of administering the pension plan. Defined benefit retirement systems receive income from returns on invested assets and contributions from employers and employees. Unlike private sector defined benefit plans which tend to be “non-contributory” (i.e., do not require employees to contribute), public employees generally contribute to defined benefit plans at a fixed rate (typically a percentage of salary) that varies among different types of employees and retirement systems. Employer contributions vary from year to year depending on investment returns and the actuarial calculations determining the value of pension obligations and the value of fund assets.

The survey was designed to examine retirement systems’ funding progress, which can be described as the funded ratio (assets divided by liabilities) or the funded status (assets minus liabilities). The funded status is also described as the amount of over-funding or under-funding.

If assets are greater than liabilities:

- The funded ratio is over 100%.
- The funded status is the amount of over-funding, sometimes referred to as “surplus.”

TYPE OF RETIREMENT SYSTEM	RETIREMENT SYSTEMS THAT RESPONDED TO THE SURVEY	RETIREMENT SYSTEMS THAT DID NOT RESPOND
State	6	0
County	22	0
City	19	13
Special District	9	15
Other ²	1	1
Total	57	29
Median Retirement System Membership	5,576	349

TABLE 1:
Characteristics of Survey Respondents

If assets are less than liabilities:

- The funded ratio is under 100%.
- The funded status is the amount of under-funding and is called the “unfunded liability” or, more formally, the “unfunded actuarial accrued liability” (UAAL).

In some cases, bonds are used to finance unfunded pension liability. However, the survey results do not capture pension obligation bond debt because retirement systems do not generally have detailed information about bonds issued by plan sponsors. According to the State Controller’s Office, pension obligation bond debt was approximately \$10 billion for counties, cities, and special districts as of June 2005. Pension obligation bonds are generally issued by the plan sponsor and backed by tax revenues. Proceeds are made available to pension fund managers for investment.

Actuarial Value versus Market Value of Assets

For the survey, retirement systems were asked to report the actuarial value of their assets, which is the same figure reported annually to the State Controller’s Office. This makes it possible to track funding progress over time using data from this survey together with data from the State Controller’s Office.

In order to stabilize the rates against financial market fluctuations, actuaries spread, or “smooth,”

investment gains and losses over a period of time. Thus, the actuarial value of assets used to determine contribution rates may be higher or lower than the actual market value of assets available to pay benefits.

In any single year, a change in actuarial methods and assumptions can have a significant impact on a plan’s reported assets and liabilities. The comments of one survey respondent illustrate this point: “These two changes [actuarial assumptions about the rate of salary increases and investment earnings] alone added \$65 million in calculated UAAL [unfunded actuarial accrued liability].” For this reason, a plan’s funding progress is more accurately viewed over time rather than at a single point in time.

A more thorough description of actuarial terms and practices is provided in the Appendix to this report.

Survey Results

1. Respondents reported a total unfunded liability of \$63.5 billion. *Table 2* shows pension plan funding status aggregated into employer categories of State, schools, and public agencies.³ The smallest unfunded liability and highest funded ratio is for the State plans, including the University of California Retirement System as well as state and California State University employees covered by CalPERS.⁴

TABLE 2:
Funding Status by Employer Type (*In billions*)

	(1) ASSETS (ACTUARIAL VALUE)	(2) LIABILITY	(3) UNFUNDED LIABILITY (2) – (1)	(4) FUNDED RATIO (1) / (2)
State (includes CSU and UC)	\$149.7	\$163.4	\$13.7	91.6%
Schools (includes school and community college districts that contract with CalSTRS and CalPERS)	\$142.3	\$165.5	\$23.2	86.0%
Public Agencies (counties, cities, special districts – includes CalPERS and independent)	\$221.9	\$247.8	\$25.9	89.5%
Non-respondents * (for city and special district retirement systems that did not respond to the survey)	\$2.1	\$2.8	\$0.7	75.0%
Total	\$516.0	\$579.5	\$63.5	89.0%

Source: 2007 California Research
Bureau Public Retirement
System Survey

* For the systems that did not respond to the survey, an estimate was calculated based on the assumption that these systems accounted for the same proportion of total retirement system assets (0.4 percent) and liability (0.5 percent) as they had in the three most recent State Controller’s Office annual report on retirement systems. The estimate also assumes that non-responding systems’ change in assets and liabilities since the fiscal year ending June 2004 occurred at the same rate as for those systems that responded to the survey.

2. The survey revealed an aggregate funded ratio of 89% for California's defined benefit public pension plans. This is lower than during the late 1990s through 2002 when the state's public systems as a whole had assets that exceeded liabilities, but about the same as the aggregate funded ratio for all public retirement systems in California in the mid-1990s.

It is important to note that the funded status of many of the systems surveyed may have improved since the most recent actuarial valuations were completed. Since 2004, for example, CalPERS and CalSTRS have experienced annual investment returns in the double digits, significantly higher than their actuarially assumed rates of return. As a result, in July

2007, CalPERS officials announced that the majority of its plans were fully funded on a market-value basis.

Chart 2 shows that 30 of 51 retirement systems reported funded ratios of 80 to 99 percent during their most recent actuarial valuations. Seven reported funded ratios greater than 100% including:

- Three closed systems with 80 or fewer members
- City of Fresno Employees' Retirement System (138%)
- City of Fresno Fire and Police (125%)
- San Francisco Employees' Retirement System (109%)
- University of California Retirement System (104%)

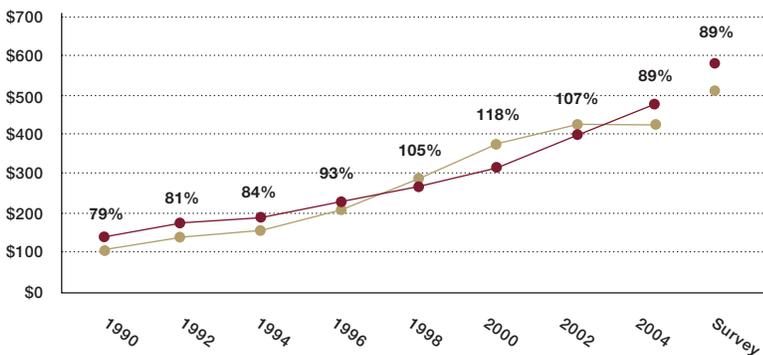


CHART 1:
Funding Status for California Public Pension Systems (In billions)

● Assets
● Liability
% Funded Ratio

Source: California State Controller's Office Public Retirement Systems Annual Reports and the 2007 California Research Bureau Public Retirement System Survey

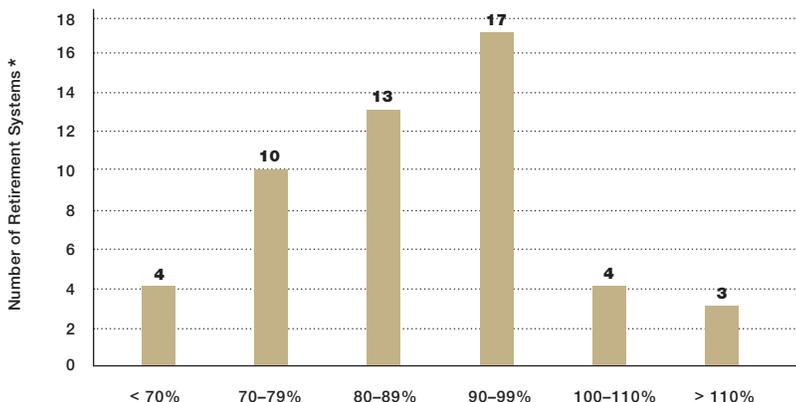


CHART 2:
Distribution of Retirement Systems by Funded Ratio

Source: 2007 California Research Bureau Public Retirement System Survey

* N=51; 6 systems are not included either because they are closed and funded on a pay-as-you-go basis with no UAAL reported, or because two or more were reported together as a single system.

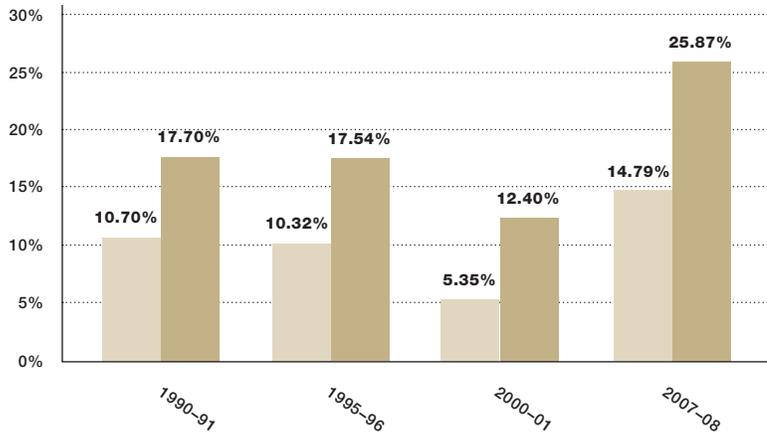


CHART 3:
Average Employer Contribution
Rate as a Percent of Payroll

Miscellaneous
Safety

Source: 2007 California Research Bureau
Public Retirement System Survey

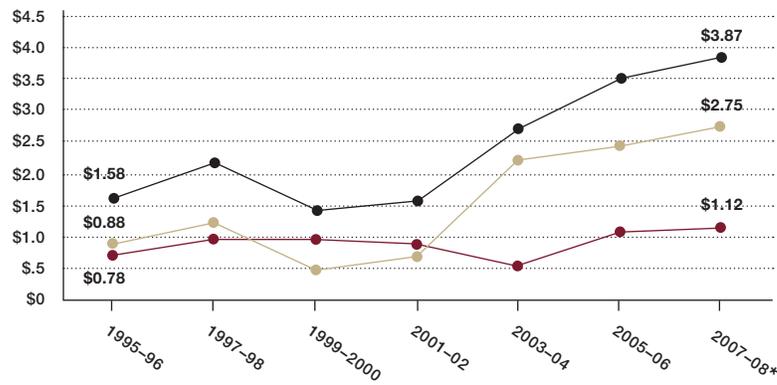


CHART 4:
State Pension Fund Contributions
(In billions)

CalPERS
CalSTRS
Total

* Estimate

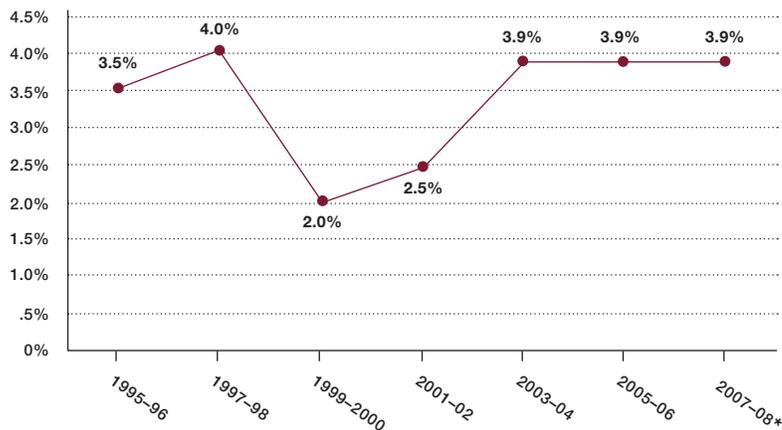


CHART 5:
State Pension Fund Contributions
as a Percentage of State General
Fund Revenues

Source: California Department of Finance

* Estimate

3. **Average contribution rates were lowered during the late 1990s as pension fund investment returns rose, but have since increased as a result of the market downturn that occurred in the early 2000s.** While funding ratios compare a retirement plan's assets to its liabilities, contribution rates reflect the actual cost that employers pay to provide pension benefits. A contribution rate is the percent of total payroll that employers are required to contribute to the plan each year. The CRB survey asked responding retirement systems to report contribution rates for their largest plans for miscellaneous employees and their largest plans for safety employees. Thirty systems provided contribution rates for public safety members and 40 provided this data for miscellaneous members. The results are shown in *Chart 3*.

4. **Even though State pension contributions have risen substantially in the past decade, they have remained at a relatively stable 3.5% to 4% of**

total general fund revenues from the mid-1990s to present. *Charts 4* and *5* are based on data provided by the California Department of Finance and are included to show the State's CalPERS and CalSTRS contributions both in terms of cost and relative to total State General Fund revenues.

Chart 4 shows that despite a significant drop in the late 1990s, the State's total CalPERS and CalSTRS contributions have risen by 145% from about \$1.58 billion in the fiscal year that ended in 1996 to a projected \$3.87 billion in fiscal year 2007/08. During that period, that State's CalPERS contribution rose by about 213% compared to 60% for CalSTRS contributions.

Chart 5 shows that despite the rising cost, State pension contributions have remained at a relatively stable three-and-a-half to four percent of total general fund revenues from the mid-1990s to present. Again, the exception is 1999 to 2002 when contributions were significantly lowered.

-
- 1 Special districts are a form of local government created by a local community to meet a specific need such as park services, police and fire protection, pest abatement, libraries, cemeteries, management of water and natural resources and the provision of utilities. According to the California Special District Association there are approximately 2,300 independent special districts in California.
 - 2 "Other" refers to the Public Agency Retirement System (PARS) Defined Benefit Plans. PARS is a multiple employer trust whose participants include various California governmental agencies including cities, school districts, community colleges, counties, and special districts.
 - 3 This figure does not include pension obligation bond debt which was approximately \$10 billion as of June, 2005.
 - 4 The State is the source of all employer pension contributions to CalSTRS.

NOTES

"Public Employee Retirement Systems Annual Report, FY 2004/05," California State Controller's Office, July 31, 2007; <http://www.sco.ca.gov/ard/local/locprep/retirement/reports/retirement0304.pdf>.

Testimony of Ron Seeling, Chief Actuary, California Public Employees' Retirement System, California Public Employee Post-Employment Benefits Commission Meeting, Burlingame, CA, July 12, 2007, p. 139, <http://www.pebc.ca.gov/images/files/Minutes-071207.pdf>.

Summary of OPEB Survey

On December 28, 2006, Governor Arnold Schwarzenegger established, by Executive Order S-25-06, the Public Employee Post-Employment Benefits Commission to propose ways for addressing unfunded post-employment benefits. The first of the Commission's three assigned missions is to: "Identify the full amount of post-employment health care and dental benefits for which California governments are liable and which remain unfunded."

As part of this mission, the Commission conducted a survey of public agencies throughout the State of California. The purpose of the survey was to collect baseline data on the number of agencies that offer other post-employment benefits (OPEB) to retirees, collect the annual costs of these benefits, and assess the amount of OPEB benefits that remain unfunded.

The Commission received survey responses from almost 1,200 public agencies in California. When weighted by revenue, the responding agencies represent 78% of combined revenues for all cities, 100% of county revenues, 73% of special district revenues, 66% of state-provided revenue to school districts, and 67% of all state revenue to community college districts. The majority of agencies that failed to respond were smaller agencies with revenues below \$100 million.

Key findings from the survey include:

- California's public employers reported a combined unfunded OPEB liability of at least \$118 billion as of their most recent actuarial valuations. The State of California accounts for 41% of the total unfunded liability. Counties account for 24% of the total unfunded liability.

- Pay-as-you-go continues to be the predominate funding strategy used by those agencies that offer OPEB benefits. Approximately 78% of the agencies which offer OPEB benefits do not prefund.
- The total amount that public employers are currently paying or setting aside for future payments is at most \$3.5 billion on an annual basis.¹

Survey Methodology and Key Concepts

OPEB Funding Approaches and GASB Requirements

In addition to the pension benefits provided to public employees upon retirement, many public employers offer other post-employment benefits (OPEB) to their retired employees. OPEB benefits typically refer to health care coverage and may also include other benefits such as dental, vision, life insurance, and long-term care.

OPEB benefits can be paid for in two ways: pay-as-you-go or prefunding. Under the pay-as-you-go approach, the employer only pays current year expenditures for OPEB benefit costs. No funds are set aside to address accumulated or future costs. Under the prefunding approach, the employer and/or current employees contribute now to pay all or a portion of the anticipated future cost of promised benefits as they are incurred.

In 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

(OPEB).” This new standard requires public employers that provide OPEB benefits to their retirees to measure and disclose annual OPEB obligations pursuant to rules applied uniformly to all employers. All California public agencies, which provide health care and other benefits to their retirees, must calculate the costs of providing those benefits on a prefunded basis. GASB 45 implementation dates are phased in and vary depending on the agency’s annual revenues:

- Fiscal years beginning after December 15, 2006 for governments with total annual revenue of \$100 million or more in the first fiscal year ending after June 15, 1999. Typically, implementation will be the 2007/08 fiscal year.
- Fiscal years beginning after December 15, 2007 for governments with total annual revenue of \$10 million to \$100 million in the first fiscal year ending after June 15, 1999. Typically, implementation will be the 2008/09 fiscal year.
- Fiscal years beginning after December 15, 2008 for governments with total annual revenue less than \$10 million in the first fiscal year ending after June 15, 1999. Typically, implementation will be the 2009/10 fiscal year.

Survey Scope

The OPEB survey was initially distributed in May and June 2007. An electronic questionnaire was sent to public agencies throughout the state, including cities, counties, special districts, school districts, and community college districts. Public agencies were identified and contacted using information provided by several resources, including the League of California Cities, California State Association

of Counties, and California Special Districts Association. In total, surveys were sent to almost 3,700 public entities in the State of California.

Throughout the fall of 2007, Commission staff sent follow-up messages to agency contacts in order to obtain additional survey responses and clarify submitted data. In particular, this outreach targeted larger agencies that were more likely to have completed an actuarial valuation to determine OPEB liability.

The survey asked agencies whether they provide OPEB benefits to retirees. Those agencies that offer OPEB benefits were asked to identify their total annual OPEB cost and funding approach (pay-as-you-go, prefunding, or both). Agencies were also asked if they had publicly released their OPEB actuarial valuation and to either provide the amount of their unfunded actuarial accrued liability (UAAL) or the anticipated date for sharing this information. Data on the number of employees, number of retirees, and annual operating budget was also requested from each agency. (Please see the Notes section for a complete list of questions included in the survey.)

Survey participants submitted data with the understanding that all information would be presented in the aggregate.

Survey Respondents

The Commission received survey responses from almost 1,200 public agencies, including most of the major public entities in California (State of California, University of California system, all 58 counties, larger cities, etc.).

PUBLIC ENTITY	TOTAL ENTITIES CONTACTED	TOTAL RETURNS	PERCENT OF TOTAL ENTITIES	PERCENT OF TOTAL REVENUES
Cities	478	231	48%	78%
Counties	58	58	100%	100%
Special District	2,052	374	18%	73%
School Districts	1,036	475	46%	66%
Community Colleges	72	39	54%	67%
University of California	1	1	100%	100%
State of California (includes CSU)	1	1	100%	100%

TABLE 1:
Survey Response Rate

Ideally, the comprehensiveness of survey data would be measured by the percentage of total public employees represented by responding agencies. Since reliable employee data was not available, an alternative measure of the percentage of total revenues was used to account for those agencies that have responded.

The University of California and State of California fully participated in the survey. As seen in *Table 1*, the 231 cities responding to the survey account for 78% of the combined revenues for all cities in California. All 58 counties responded to the survey. Of the 2,052 special districts contacted by the Commission, a total of 374 responded to the survey.² These responses represent 73% of the revenue provided for special districts. About 46% of school districts responded, representing 66% of state-provided revenue to schools. Thirty-nine (39) of the 72 community colleges responded, accounting for 67% of all state revenue to community colleges.³

Non-Respondents

The majority of agencies that did not respond to the survey tended to be smaller agencies with revenues below \$100 million. As noted above, under GASB guidelines, many of these agencies are not required to conduct OPEB valuations until the fiscal year beginning after December 2007 or December 2008. Other entities were still in the process of assessing their OPEB liability and did not have the information available to share. Agencies who do not offer OPEB benefits also may have been less inclined to complete the survey. Using the most recent revenue data available, *Table 2* provides additional details on agencies that did not return survey data.

Timeliness of Data

The survey asked public agencies to report OPEB data for the “most recent period available.” The majority of respondents provided data for FY 2006/07 and FY 2007/08. It is important to note

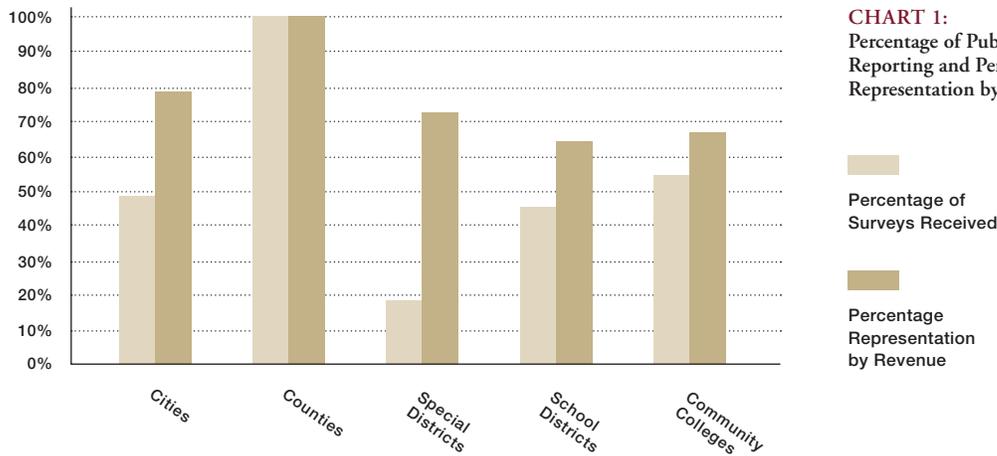


TABLE 2:
Non-Respondents by Annual Revenue

	OVER \$100 MILLION	LESS THAN \$100 MILLION
Cities	36	211
Special Districts ⁴	4	1,489
School Districts	53	508
Community College Districts	5	28
Total	98	2,236

that all data were self-reported by each agency and reflects a point-in-time snapshot of OPEB liabilities.

within California. Based on responses received, the UAAL will be at least \$118 billion pursuant to the reporting rules adopted by GASB.⁵

Survey Findings

1. A limited number of public employers have completed their OPEB actuarial studies to determine their unfunded liability.

The survey asked public agencies whether they had publicly released their OPEB actuarial valuation and the amount of their unfunded actuarial accrued liability (UAAL), if available. Those agencies that had not publicly released their UAAL were asked to provide the anticipated date for releasing this information. Approximately 37% of survey responses where the employer indicated that they offer OPEB benefits also included data on OPEB liability.

This response rate most likely reflects the fact that many agencies are in the process of complying with GASB requirements. Even as public agencies begin to understand and meet GASB standards, there is likely to be some lag before this information is publicly disclosed. Eighty-eight percent (88%) of the survey responses that did not include an UAAL were from agencies with annual revenues of less than \$100 million. Forty-nine percent (49%) indicated that they plan to complete their actuarial study in 2008 or 2009.

2. Given the limited number of agencies that provided the results of their OPEB actuarial studies, it is difficult to project those findings with accuracy in order to determine the unfund-ed actuarial accrued liability (UAAL) for all public agencies

The 338 public agencies that reported UAAL data reported a total unfunded OPEB liability of at least \$118 billion. This figure most likely reflects their UAAL based on their current funding methodology. *Table 3* provides additional detail regarding the UAAL for each category of agency.

A Look at the “Top 10”

As an additional analysis, the Commission considered the OPEB benefit UAAL for the ten largest public agencies in each of the five survey categories (cities, counties, special districts, school districts, and community colleges) along with the state agencies. The “Top 10” cities and counties were selected based on population. School districts and community college districts were identified based on enrollment data. The larger special districts were selected based on revenue.

By category, the 10 largest cities responding to the survey represent 46% of the combined revenues of all California cities. The 10 largest counties represent 66% of the combined county revenues. The 10 special districts represent 32% of the revenue expended by all special districts in California. The largest 10 school districts represent 22% of revenue for all school districts combined. For community colleges, the top 10 represent 35% of all community college revenues.

	TOTAL VALUES (\$)
Cities	\$8,818,191,807
Counties	\$28,008,890,314
Special Districts	\$3,493,610,596
School Districts	\$15,902,000,433
Community College Districts	\$2,523,812,196
UC	\$11,500,000,000
State	\$47,880,000,000
Total	\$118,126,505,346

TABLE 3:
California Public Employers
Unfunded Actuarial Accrued Liability
(UAAL)

When the ten largest agencies in each category are totaled, along with the University of California and the State, their combined UAAL is \$108 billion. These agencies account for 92% of the UAAL reported in the survey. The selection of these 52 public agencies also provides a cross section of the various approaches to funding OPEB benefits found throughout California. Historically, most of these agencies have utilized only a pay-as-you-go approach to meeting the annual costs of OPEB benefits. Others have reported that they do not provide OPEB benefits to their retirees, and others have prefunded their OPEB obligations for several years. Some of these employers are changing their responsibilities concerning retiree health care in the future. Many of these approaches are detailed in the Case Studies section of this report.

3. Majority of California public employers responding to the survey provide OPEB benefits to retirees.

A majority of public agencies responding to the survey stated they provide health care benefits to retirees. Eighty-six percent (86%) of the cities responding to the survey offer OPEB benefits. Ninety-one percent (91%) of counties, 63% of special districts, 89% of school districts, and 100% of the community college districts responding to the survey provide OPEB benefits. The State of California and University of California system also indicated that they provide OPEB benefits to their retirees.

It is important to note that the survey did not seek additional information regarding the terms under which these agencies provide OPEB benefits to retirees. Some respondents may allow access to the employer’s group health plan at the retirees’ own expense, while others may also make contributions toward the cost of retiree health care coverage. The survey did not request information as to whether the employer provides a contribution toward OPEB benefits.

4. The pay-as-you-go approach continues to be the predominate funding strategy used by those agencies that offer OPEB benefits. The total amount that public employers are currently paying or setting aside for future payments is at most \$3.5 billion on an annual basis.

Survey data shows that 78% of the agencies offering OPEB benefits currently use the pay-as-you go funding method. The survey also found that 22% have already begun to prefund their OPEB benefits.⁶ *Table 5* provides additional details regarding the funding methods used by the public agencies who offer OPEB benefits.

As seen in *Table 6*, the total amount that public employers are currently paying or setting aside for future payments is at most \$3.5 billion on an annual basis. As self-reported by the agencies, pay-as-you-go costs accounted for \$2.9 billion of this amount, a figure which reflects the predominate use of this approach by public agencies.

	# PROVIDING	% PROVIDING
Cities	198	86%
Counties	53	91%
Special Districts *	188	63%
School Districts	423	89%
Community College Districts	39	100%
UC	1	100%
State	1	100%
Total	903	82%

TABLE 4:
California Public Employers Providing
OPEB Benefits

* Count excludes dependent districts.

It should be noted that the survey asked for total annual OPEB costs and did not differentiate between incurred liabilities and the money currently being paid out for current benefits. The figures reported by agencies may also include payments made by retirees.

5. The ratio of employees to retirees is similar throughout public agencies.

The survey responses provide the ratio of active employees to retired employees for those agencies

	PAY-AS-YOU-GO ONLY	PREFUNDING
Cities	80%	20%
Counties	77%	23%
Special Districts	78%	22%
School Districts	79%	21%
Community College Districts	51%	49%
UC	100%	0%
State	100%	0%
Total	78%	22%

TABLE 5:
Approaches to Funding
OPEB Benefits

	PAY-AS-YOU-GO	PREFUNDING	TOTAL ANNUAL OPEB COSTS
Cities	\$328,233,844	\$170,409,717	\$506,319,361
Counties	\$495,505,153	\$67,781,277	\$562,825,355
Special Districts	\$141,221,958	\$92,783,061	\$279,049,830
School Districts	\$693,195,338	\$98,898,137	\$794,017,512
Community College Districts	\$110,952,446	\$29,175,996	\$150,228,723
UC	\$205,000,000	\$0	\$205,000,000
State	\$1,019,368,000	\$0	\$1,019,368,000
Total	\$2,993,476,739	\$459,048,188	\$3,516,808,781

TABLE 6:
Total Annual Employer
OPEB Costs

Note: Agencies were asked to provide three data points related to OPEB costs: total annual OPEB cost, pay-as-you go cost, and prefunding cost. In some instances, the sum of the submitted pay-as-you-go and prefunding costs did not equal the amount submitted as the total annual cost. This accounts for the discrepancy in Table 6. This information was included in order to give the reader a sense of the magnitude of the costs.

	NUMBER OF EMPLOYEES	NUMBER OF RETIREES	EMPLOYEE TO RETIREE RATIO
Cities	159,074	70,017	2.3:1
Counties	274,848	126,229	2.2:1
Special Districts	41,525	20,289	2.0:1
School Districts	384,171	84,768	4.5:1
Community College Districts	37,384	13,905	2.7:1
UC	113,000	33,000	3.4:1
State	325,157	136,796	2.4:1
Total	1,335,159	485,004	2.8:1

TABLE 7:
Employee to Retiree
Ratio for Agencies
Offering OPEB Benefits

who offer OPEB benefits. The overall average is a ratio of 2.8 employees to each retiree.

The ratio of active to retired employees is important when considering the general impact that retired employees have upon utilization of health plans and premium costs. It is generally accepted that age has an impact on utilization of health care services. That is, the older the person, the more likely s/he is to use the health plan. Higher health plan utilization typically means higher costs. This impact is most significant for the non-Medicare retiree population (typically described as early retirees), because retirees in Medicare supplement plans are not usually pooled with actives. Consequently, the larger the early retiree population, the higher health plan costs will be.

Under GASB reporting requirements, this cost of having active and retired employees in the same health care risk pool is identified as the implicit rate subsidy. This subsidy is the difference between expected claims for retirees and their premium cost. Essentially, this means that if actives and retirees were priced separately, the active employee's premium would decrease (compared to a pooled premium), while the retiree's premium would increase (compared to a pooled premium).

Conclusion

The Commission's OPEB survey represents an initial effort to collect data on OPEB liabilities from

agencies throughout California. The results of this survey should be viewed as point-in-time, self-reported data that provides some insight about the order of magnitude of public employers' unfunded OPEB obligations. As public agencies continue to comply with GASB 45 and evaluate options for meeting OPEB obligations, there is a need for an ongoing reporting mechanism to periodically collect data and make this information available to the public in a consistent, accurate format. In light of this need, the Commission has recommended that the State Controller's Office develop a simple and inexpensive procedure to collect OPEB data from public agencies on an ongoing basis.

In addition, it is important to consider the sensitivity of the OPEB UAAL based on actuarial assumptions. In particular, assumptions regarding the rate of health care inflation are prone to change and can have a critical impact on the amount of an agency's unfunded liability. Although the results of this survey identify an initial UAAL of at least \$118 billion, this number may change significantly over time if actual health care inflation varies from the assumed rate of inflation. Because of the volatility of this key assumption, ongoing reporting and evaluation of this assumption will be an important part of understanding the total OPEB liability of California's public employers.

-
- 1 The survey asked agencies to provide their "Total Annual OPEB Costs." Some agencies may have reported incurred liabilities rather than the money being paid out for current benefits.
 - 2 Cities and counties were asked to identify any dependent districts under their jurisdiction. The response rate for special districts includes those districts that were identified as a "dependent district."
 - 3 Sources for all revenue data referenced throughout this report: 2004/05 revenue data for cities, counties, and special districts from the State Controller's Office; 2005/06 revenue data for school districts from the California Department of Education; and 2005/06 revenue data for community college districts from the California Community Colleges Chancellor's Office. Revenue data was not available for all special districts contacted by the Commission. As such, all revenue calculations do not reflect these districts.
 - 4 Break-out only includes those special districts for which revenue data was available.
 - 5 The projection of \$118 billion reflects the total liability for California public agencies over the next 30 years and does not represent a single-year liability or cost.
 - 6 The count of agencies using the prefunding approach includes agencies who indicated an OPEB funding method of "Prefunded" or "Both."

Notes Section

Copy of OPEB Survey Questionnaire

Please have your Chief Financial Officer, or person most familiar with your pension fund and other retiree obligations, complete the following survey and submit to us online.

For this survey: Government Code (Sections 7500-7514.5) and GASB provide direction for collecting and reporting pension information. GASB Statement No. 45 now requires that state and local government employers account for and report the annual cost of non-pension benefits.

Public Employee
Post-Employment
Benefits Commission

Summary of
OPEB Survey

-
-
- I. Please provide us with information about your public entity, the non-pension benefits such as health, dental, vision (often called Other Post-Employment Benefits - OPEB) that you provide employees, and a contact person.

Public Entity Reporting

Full Formal Name of
District, City, County, or Public Entity: _____

What type of public entity is this?

- City
- County
- Special District
- School District
- Community College

Cities and Counties Only:
Do you have Dependent
Districts?

- Yes
- No

If "Yes", indicate them
here and include them in
your reporting:

Contact Person

Name: _____ Position or Title: _____

Phone Number: _____ E-mail: _____

Mailing Address: _____

II. Please provide us the following post-employment benefit (OPEB) information.

1. Does your public entity provide retirees with any non-pension benefit coverage (health, dental, vision, etc.):

Yes

No

Note: Answer “Yes” even if those benefits are paid by retirees. If no, skip to the end and submit your information. Thank you.

2. If Yes, are these benefits (Check one):

Pre-funded

Pay-as-you-go

Both

Note: Generally, Pre-funding is collecting benefit funds while the employee is working. “Pay-as-you-go” is the employer or the retiree buying coverage once the retiree requires benefits.

3. Please indicate the number of current and past employees for your entity:

Active Employees: _____

Retirees: _____

4. Please provide the following OPEB (non-pension) amounts for the most recent period available (in dollars).

What is your total operating budget: _____

What are your current TOTAL annual costs for OPEB: _____

For which period you are reporting: _____

How much of these annual costs are: Pay-as-you-go: _____ Pre-funded: _____

What is the source of your information?

CAFR or Year End Financial Statement

Actuarial Review

Other

5. Has your entity publicly released your actuarial valuation for retiree OPEB liability?

Yes

No

If Yes, what is your entity's Unfunded Actuarial Accrued Liability (UAAL) and the corresponding discount rate for OPEB?

UAAL: _____

Discount Rate: _____

If No, when do you anticipate releasing that information (mm/dd/yyyy)? _____

6. Comments

Public Agencies' Approaches to Meeting Pension and OPEB Obligations

As a part of its mission, the Commission was given the task of evaluating and comparing various approaches for addressing governments' unfunded retirement health care and pension obligations. In response, the Commission has developed a series of case study profiles that describe the experiences of California public agencies in addressing their pension and OPEB liabilities. The case studies do not endorse any one particular approach made by the participating public employers; instead they provide multiple models for consideration and review.

The case studies are divided into two sections:

- **Section I: *City, County, and Special District Case Studies***—This section presents detailed profiles of cities, counties, and special districts from throughout the state. Each profile includes background on the agency's pension and retiree health benefits, vesting and eligibility guidelines, pension and OPEB costs, and method of funding retiree health care obligations.
- **Section II: *School District and Community College District Case Studies***—This section discusses some of the unique aspects of pension and OPEB benefits for school employees. Profiles of individual school districts are also included which present an in-depth view of individual school districts' health care benefits, funding methods, and associated costs.

Case Study Methodology

The Commission's case study project was initiated in June 2007. In order to identify the agencies profiled in this report, Commission staff made inquiries to Commission members, agency experts, the League of California Cities, the California State Association of Counties, the California Special Districts Association, and public employees' associations and unions. An effort was made to include public agencies that have prefunded to various degrees and through different methods, as well as public employers that fund OPEB benefits on a pay-as-you-go basis. Consideration was also given to geographic diversity in order to represent regions throughout the state.

All agencies described in this report completed written surveys to provide information on pensions and OPEB offerings. These surveys were completed by a variety of reporters such as City Managers, Finance Directors, County Administrative Officers, Personnel Directors, and Retirement System Administrators. Informal follow-up interviews were conducted by Commission staff in order to clarify survey responses and obtain additional information on areas of particular interest.

All public agencies appearing in this report were voluntary participants. The assistance and cooperation of case study participants was a vital component in the completion of this project. All case study profiles were subject to the review of the participating agencies.

The following agencies are profiled in this report:

Cities

- City of Los Angeles
- City of Foster City
- City of Fresno
- City of Mountain View
- City of San Rafael
- City of Thousand Oaks

Counties

- County of Alameda
- County of El Dorado
- County of Los Angeles
- County of Orange
- County of San Diego
- City and County of San Francisco
- County of Santa Clara
- County of Trinity

Special Districts

- Alameda County Mosquito Abatement District
- Sacramento Municipal Utility District
- Western Municipal Water District

Multi-Agency Medical Trusts

- Medical Trusts – Central Valley
- Medical Trusts – North State

School Districts

- Elk Grove Unified School District
- Encinitas Union School District

- Los Angeles Unified School District
- Modesto City Schools District
- North Sacramento Elementary School District
- Solana Beach School District

County Office of Education

- Sacramento County Office of Education

Community College District

- Los Angeles Community College District

Due to the size of the case study sample and the method of choosing participants, these case studies should not be assumed to be representative of all public agencies in California. No projections should be made and no statistics computed from the results of these case studies.

Section I: City, County, and Special District Case Studies

Background

In order to set some initial context for the city, county, and special district case studies, this section provides information related to public sector retirement benefits, including an explanation of retirement formulas and public employees' participation in Social Security and Medicare. Overviews of the California Public Employees' Retirement System (CalPERS) and retirement systems subject to the County Employees' Retirement Law of 1937 ('37 Act) are also provided.

Defined Benefit Retirement Formulas

Defined benefit retirement plans provide monthly allowances for employees who retire for service or disability. They also provide monthly allowances to eligible survivors of employees who die prior to or following retirement.

As seen throughout the case studies, retirement formulas are typically titled in such a way as to describe how a retirement benefit would be calculated, such as "2% at age 55." The specified age is considered the "normal" retirement age. Under the "2% at age 55" formula, an employee would receive 2% of his average monthly pay rate for each year of service if he retires at age 55. The formula would be: $2\% \times \text{years of service} \times \text{average monthly pay rate}$.

For example, an individual who retires at age 55, with 25 years of service, and whose average monthly pay rate is \$5,000 would receive a basic retirement allowance of \$2,500 per month ($2\% \times 25 \text{ years} \times \$5,000$). Individuals who retire earlier than age 55 would have their retirement based on a percentage that is less than 2% and individuals who retire

older than age 55 would have benefits based on a percentage that is greater than 2%.

California Public Employee Participation in Social Security

Prior to 1954, state and local governmental agencies were unable to provide Social Security coverage for their employees. Although local government agencies could choose to provide Social Security coverage after that date, it was not until 1961 that the State of California elected to provide coverage for its employees. Other than fire and police, employees who are members of a government agency's pension plan become covered by Social Security once the agency contracts for coverage. Agencies can also extend Social Security coverage separately to fire and police groups.

A number of public agencies in California do not provide Social Security to their employees. It is generally agreed that about half of all public employees do not participate in Social Security. As a result, many employees may live on their retirement benefits without any supplement from Social Security. The single largest group of public employees who are not subject to Social Security coverage are public school teachers and administrators who are members of the California State Teachers' Retirement System. (See the introduction to the Schools Case Study for additional information.) Most public safety employees also do not participate in Social Security.

In addition, any Social Security payments which may be earned from a second job or a spouse's employment may be reduced due to the Windfall

Elimination Provision (WEP) and Government Pension Offset (GPO), which affect all who work for public employers that do not pay into the Social Security System. The WEP reduces the earned Social Security benefit of a person, if that person receives a government pension benefit from an agency which is not covered by Social Security. The GPO reduces spousal Social Security benefits paid to public employees who receive a government pension from service not covered by Social Security.

Since 1991, the federal government has required public employees who are not members of a qualified pension plan to contribute to Social Security or to an alternate plan. Any such alternate plan must have a total contribution of at least 7.5% of payroll. Many agencies contract with outside vendors to offer a Defined Contribution type plan with a 7.5% total contribution rate as a means of addressing the mandatory Social Security requirement.

Public Employee Participation in Medicare

Medicare was created in 1965. Coverage was automatically extended to governmental employees who were subject to Social Security coverage. In 1986, federal legislation was passed extending Medicare coverage to all governmental employees hired on or after April 20, 1986 who are not covered by Social Security.

State legislation was enacted in 1989 which allows local school districts to hold an employee election to determine if they want to extend Medicare coverage to employees hired prior to April 20, 1986. Currently, 881 school districts have elected to extend Medicare coverage to their senior teachers and administrators. (See the introduction to the Schools Case Study for additional information.)

California Public Employees' Retirement System

The majority of public employers highlighted in the case studies participate in the California Public Employees' Retirement System (CalPERS), the nation's first state employees' retirement system. CalPERS is a defined benefit retirement plan that was established in 1932. In 1939, other public agencies and classified school employees were allowed to join the CalPERS pension system. Today, 30% of CalPERS members are state employees, 38% are school employees, and 32% are local public

employees. With 75 years of operation, the system manages pension and health care benefits for approximately 1.5 million members (70% active employees, 30% retirees).¹

The CalPERS defined benefit retirement plan provides benefits based on a member's years of service, age, and highest compensation. In addition, benefits are provided upon disability or death, with payments in some cases going to survivors or beneficiaries of eligible members. CalPERS is administered by a 13-member Board of Administration. Board members are either elected by members of the system, appointed by the Governor or Legislature, or designated by law to be on the board. The board has established various committees which review issues and recommend actions to the full board.

With approximately \$250 billion in assets, CalPERS is the largest public pension system in the country. CalPERS is comprised of a total of 15 funds, including five defined benefit pension funds, four defined contribution pension funds, four proprietary funds, and two agency funds.

The Public Employees' Retirement Fund (PERF) is the primary fund administered by CalPERS. Actuarial valuations are used to determine the cost of pension benefits and the related required contribution rates paid by public employers (and employees) who participate in CalPERS, the Legislators' Retirement System (LRS), and the Judges' Retirement System (JRS I and II). The State of California and 1,544 public agency and school employers contribute to the PERF. Utilizing the actuarial value of assets, the PERF is funded at 87.3% as of June 2006, which means it can meet 87.3% of its actuarial assumed liability for current and retired employees. The funded ratio for public agency plans is 92.7%.

Employer contribution rates for cities, counties, and special districts within CalPERS differ from employer to employer, but all schools have one employer contribution rate for their classified employees. For fiscal year 2007/08, the school employer contribution rate is 9.306% of payroll.

The Public Employees' Medical and Hospital Care Act (PEMCHA) was passed in 1962 establishing the

CalPERS health benefits program for state employees. In 1967, the program was expanded to allow other public employers the option to contract for participation. CalPERS is the third largest purchaser of employee health benefits in the nation, behind the federal government and General Motors, and is the largest purchaser in California. CalPERS will spend approximately \$5 billion in 2007 to purchase health benefits for its participants. Of the employees and retirees who participate in the CalPERS health benefits program, 61% are state employees and 39% are local government and classified school employees.

The CalPERS health benefits program offers participants access to three health maintenance organizations (HMOs), two preferred provider organizations (PPOs), and three special plans for participants belonging to the California Association of Highway Patrolmen (CAHP), the California Correctional Peace Officers Association (CCPOA), and the Peace Officer Research Association of California (PORAC).

PEMHCA provides some guidelines for establishing an employer contribution rate, but for local agencies, the employer contribution is ultimately determined through collective bargaining and/or a resolution of the governing body of the agency. PEMHCA also generally requires the employer contribution for retirees to be the same as the employer contribution for active employees.

Retiree Information: (as of June 30, 2007)

- Average monthly service retirement allowance for all retirees: \$1,881
- Average years of service for all retirees: 19.9
- Average monthly service retirement allowance for school miscellaneous members: \$1,040
- Average years of service for school retirees: 16.5
- Average monthly service retirement allowance for state members: \$2,205
- Average years of service for state retirees: 22.6
- Average age at retirement for all members: Service: 60, Disability: 50, Industrial disability: 46
- 86% of CalPERS retirees, survivors, and beneficiaries live in California

- CalPERS offers 13 retirement formulas; 57 optional contract provisions
- 23,098 new retirees were added during the 2006/07 fiscal year
- \$10.07 billion in benefits were paid during the year ending June 30, 2007

County Employees' Retirement Law of 1937 ('37 Act Counties)

Several of the counties included in the case study profiles operate a retirement system under the provisions of the County Employees' Retirement Law of 1937 ('37 Act).² This law allows individual counties to establish independent retirement systems by the adoption of an ordinance accepting the provisions of the act. Twenty California counties operate retirement systems under the provisions of the '37 Act: Alameda, Contra Costa, Fresno, Imperial, Kern, Los Angeles, Marin, Mendocino, Merced, Orange, Sacramento, San Bernardino, San Diego, San Joaquin, San Mateo, Santa Barbara, Sonoma, Stanislaus, Tulare, and Ventura. Los Angeles was the first county to adopt the '37 Act provisions in 1938. Imperial was the last, establishing its system in 1951. Most of the counties created their systems in the mid-1940s.

Except for the Board of Investment in Los Angeles County and the statutory duties of the County Treasurer, the management of each county retirement system is vested in the Board of Retirement, consisting of nine members. Four are employees (2 general, 1 safety, 1 retired, all elected by their peers for 3-year terms); four are appointed to 3-year terms by the Board of Supervisors; and one is the County Treasurer.

The 20 county retirement systems under the '37 Act are also part of the State Association of County Retirement Systems (SACRS).³

- Collectively, the retirement systems' assets are in excess of \$100 billion, with the median county having \$2.0 billion in assets.
- Collectively, the '37 Act systems disbursed benefit payments in 2006 to 121,042 retirees, survivors, and disabled employees. The average monthly check was \$2,383.

- In 2006, the average '37 Act system general (miscellaneous) member retired at age 58 after 19 years of service and received a monthly benefit payment of \$1,833.
- The average '37 Act system safety member retired at age 52 after almost 22 years of service and received a monthly benefit payment of \$3,715.

TABLE:
City, County and Special District Case Study At-A-Glance Matrix

The following matrix provides a brief summary of the pension and OPEB benefits offered by each agency included in the case study profiles. Please see each agency's profile for detailed information.

AGENCY	OPEB FUNDING METHOD	ACTIVE EMPLOYEES	RETIRED EMPLOYEES	REVENUE	PARTICIPATES IN SOCIAL SECURITY?	PROVIDES PENSIONS	PROVIDES RETIREE HEALTH CARE	ELEGIBILITY FOR RETIREE HEALTH CARE
Alameda County	OPEB benefits paid by ACERA's excess earnings reserve	10,514	6,591	\$2.2 billion	✓	✓	✓	Minimum age 50 with 10 years service; or any age with 30 years service; or age 70, regardless of service.
Alameda County Mosquito Abatement District	Pay-as-you-go	13	11	\$2.3 million	No	✓	✓	If hired after Nov. 2003, must have 10 years of service. Full employer contribution provided with 20 or more years of service.
Central Valley Medical Trust	Individual retiree medical reimbursement trust	720	11	\$900 million	✓	✓	✓	Based on collective bargaining agreements, varies between bargaining units
El Dorado County	Revocable fund with county treasurer	2,040	336	\$288 million	No	✓	✓	Minimum age 50 with 12 years of service; contribution amount based on total years of service.
City of Foster City	Pay-as-you-go	251	168	\$26.5 million	No	✓	✓	Minimum age 50 with 5 years service. Active employees provided with a VEBA to self-fund out-of-pocket retiree health care costs.

* Only for Miscellaneous (General) Employees

Section I

AGENCY	OPEB FUNDING METHOD	ACTIVE EMPLOYEES	RETIRED EMPLOYEES	REVENUE	PARTICIPATES IN SOCIAL SECURITY?	PROVIDES PENSIONS	PROVIDES RETIREE HEALTH CARE	ELEGIBILITY FOR RETIREE HEALTH CARE
City of Fresno	OPEB benefits paid by retirement systems' excess earnings reserve	3,413	2,153	\$1 billion	No	✓	✓	5 years of service and at least the minimum retirement age.
City of Los Angeles	Trust administered by LACERS	30,175	14,836	\$5.3 billion	No	✓	✓	Minimum age 55 with 10 years service; contribution amount based on total years of service.
Los Angeles County	401(h) account through LACERA	92,000	51,000	\$21.0 billion	No	✓	✓	10 years of service and at least the minimum retirement age; contribution amount based on total years of service.
City of Mountain View	Revocable reserve account	589	250	\$208 million	No	✓	✓	If hired before 7/1/07, subject to a tiered eligibility structure based upon bargained criteria. If hired on or after 7/1/07, 15 years of service and minimum of age 50. New hires have option of alternative DC plan in lieu of retiree health contributions.
North State Public Safety Retiree Medical Trust	Individual retiree medical reimbursement trust	221	46	\$42 million	✓	✓	✓	10 years from start of program or employment hire date, whichever is later.
Orange County	401(h) account through OCERS	16,868	8,914	\$5.6 billion	No	✓	✓	Minimum age 50 with 10 years of service
San Diego County	401(h) account through SDCERA	17,451	12,049	\$3.6 billion	✓ *	✓	✓	Retiree health benefits limited to retirees in Tier I and Tier II (generally hired before 3/8/02); for others, coverage may be purchased at full cost to the retiree.

* Only for Miscellaneous (General) Employees

AGENCY	OPEB FUNDING METHOD	ACTIVE EMPLOYEES	RETIRED EMPLOYEES	REVENUE	PARTICIPATES IN SOCIAL SECURITY?	PROVIDES PENSIONS	PROVIDES RETIREE HEALTH CARE	ELEGIBILITY FOR RETIREE HEALTH CARE
San Francisco City and County	Pay-as-you-go	29,174	20,185	\$5.7 billion	✓ *	✓	✓	Minimum 5 years of service
City of San Rafael	401(h) account through MCERA	589	254	\$66.5 million	No	✓	✓	Minimum age 50 with 5 years of service
Santa Clara County	Revocable fund with county treasurer	15,069	6,712	\$3.5 billion	✓ *	✓	✓	Minimum age 50 with 5 years service, if hired before 8/12/96; 8 years service, if hired after 8/11/96; and 10 years service, if hired after 6/18/06.
Sacramento Municipal Utilities	Revocable reserve account	2,026	1,338	\$1.4 billion	✓	✓	✓	Minimum age 50 with 5 years of service; contribution amount based on hire date and total years of service.
City of Thousand Oaks	Irrevocable fund administered by CalPERS	432	165	\$135 million	No	✓	✓	Minimum age 50 with 5 years of service
Trinity County	115 trust administered by PARS	394	234	\$58 million	✓	✓	✓	Minimum age 50 with 5 years of service
Western Municipal Water District	VEBA	124	30	\$93 million	✓	✓	✓	Minimum age 55 with 12 years service

* Only for Miscellaneous (General) Employees

1 CalPERS Facts At A Glance, July 2007. <http://www.calpers.ca.gov/index.jsp?bc=/about/facts/home.xml>

2 Of the 58 California counties, 20 operate retirement systems under the provisions of the '37 Act; 2 administer independent county systems; and the remaining 36 counties participate in CalPERS.

3 *The Economic Impacts on California and Counties of SACRS Members' Benefit Payments*, Robert Fountain and Bob Waste, Applied Research Center, California State University, Sacramento, September 2007.

Case Study Profile: City of Los Angeles

Type of Agency:	Charter City
Number of Employees:	30,175 Active Employees; 14,836 Retired Employees
Revenues:	\$5,379,550,000 (2006/07)
Total Payroll:	\$1,646,000,000 (2006/07)
Participates in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Minimum of 10 years service and retired at a minimum age of 55.

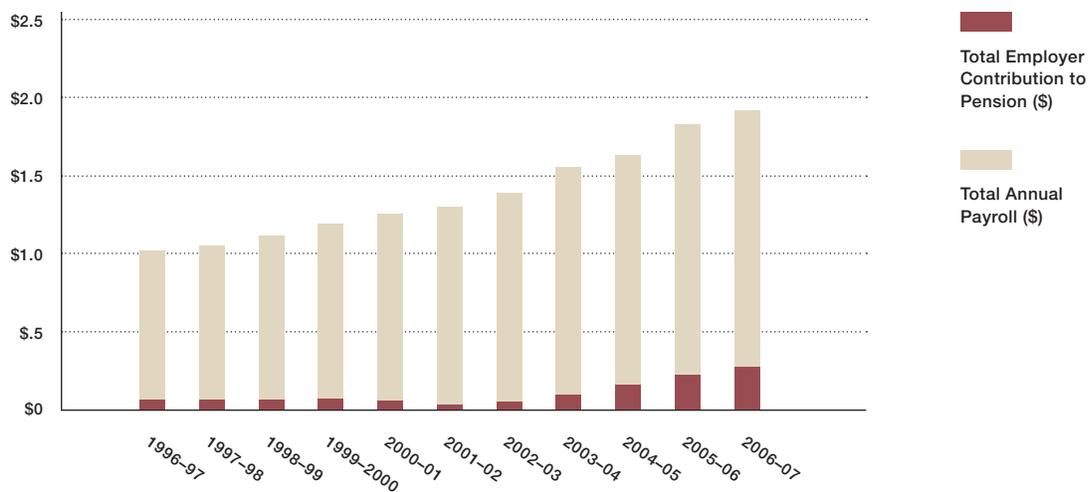
Background

Los Angeles is the second largest city in the country, with a population of almost four million. The City is located in Southern California and was founded in 1781. Los Angeles was incorporated in 1850 under charter rule provisions and operates as a mayor-city council form of government. The City's economy is based on services, wholesale and retail trade, manufacturing, government, financial services, transportation, and construction industries. The City's largest revenue sources for General Fund and program activities are charges for City services (14.9%) and property tax (25.4%).

Pensions

The City of Los Angeles operates an independent system called the Los Angeles City Employees Retirement System (LACERS). Established in 1937, LACERS is a public employee retirement system for all regular full-time and eligible part-time City employees except the Department of Water and Power and sworn personnel of the Los Angeles Police and Fire Departments. LACERS is a reciprocal agency with CalPERS and 37 other California public pension funds, allowing members to transfer between public retirement plans to receive an accumulated retirement benefit. LACERS administers retirement and health care plans for retired employees.

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In billions*)



According to the Los Angeles Administrative Code whose provisions govern LACERS, pensions are considered vested in LACERS after five years of employment. The benefit formula for miscellaneous (general) employees is set at “2.16% x service credit x 12-month final compensation,” remaining unchanged since 1975. Final compensation is determined using base pay plus regularly assigned bonuses and premium pay. The City charter only allows the mayor and city council to make changes to benefit levels.

As shown in *Charts 1* and *2*, employer pension contributions have ranged from 2.54% (2001/02) to 16.88% (2006/07) of total annual payroll costs over the last ten years.

Total system assets were valued at \$11.1 billion as of June 30, 2007. The last actuarial valuation determined the total funded ratio to be 81.7%.

As seen in the *Chart 3*, investment returns have averaged approximately 12.88% over the last five years, compared to the actuarial assumed rate of return of 8.0%. When actuarial investment returns deviate from the assumed rate of return, attempts are made to stabilize employer contributions by 1) only recognizing a portion (20%) of the gains to stabilize valuation assets and the city’s contribution; and 2) amortizing investment gains or losses over 15 years to reduce the contribution.

Retiree Health Care

LACERS administers health care benefits for retired members. Retirees have access to health, dental, vision, and death benefits. Active and retired employees are not in the same health care cost pool, and plans have been negotiated separately since 1985.

Retired employees receive a monthly subsidy towards health care benefits that is based on years of service. On average, the subsidy covers 87-91% of aggregate monthly premiums. Retiree health benefits are not considered vested since they are authorized by the City's Administrative Code, which can be changed by the mayor and city council. Therefore, health benefits are not guaranteed to the same extent as the retirement allowance.

In order to qualify for the retiree health care subsidy, an employee must complete ten years of service,

retire, and attain a minimum age of 55. Within limits, the amount of the subsidy is based on the LACERS board's discretion. For calendar year 2008, the maximum amount of the subsidy is \$1,022 per month.¹ The actual amount of an individual retiree's health care subsidy is determined based on the following criteria:

- Retirees under the age of 65, or retirees over the age of 65 with Medicare Part B only, receive 4% for each whole year of service. (For example, a retiree with 20 whole years of service is eligible for up to 80% of the subsidy.) The subsidy amount cannot exceed the cost of premiums for the plan in which the retiree has enrolled.
- Retirees over the age of 65 with Medicare Parts A & B receive a subsidy that varies based on length of service: retirees with 10-14 whole years of service

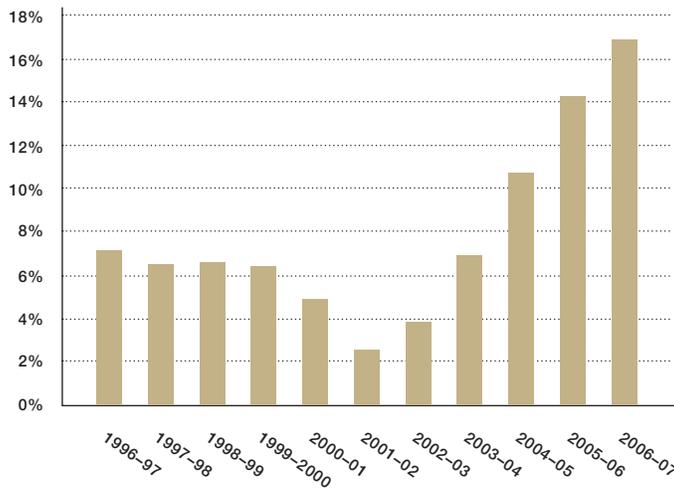


CHART 2:
Employer Pension Contribution as
a Percentage of Annual Payroll

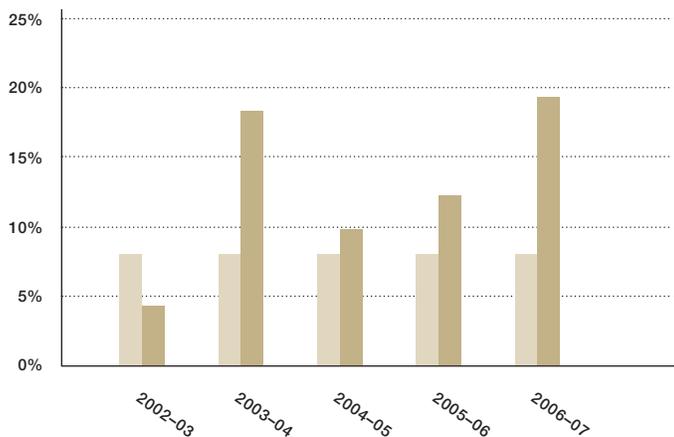


CHART 3:
Actuarial Assumed Return vs.
Actual Investment Return

Actuarial Assumed
Rate of Return (%)

Annual Net
Investment
Earnings (%)

receive 75% of the subsidy; retirees with 15-19 whole years of service are eligible for 90% of the subsidy; and retirees with 20 or more whole years of service are eligible for 100% of the subsidy.²

As shown in *Chart 4*, health care premiums have risen over the last seven years. The highest increase in premium costs occurred in fiscal year 2001/02, when premium costs increased by \$8.65 million. The retirees' portion of health care premiums ranged from 8.81% to 12.26% of the total premium costs.

Since 1987, LACERS has operated a Post-Employment Healthcare Plan for the prefunding of retiree health care benefits. Due to the significant costs of prefunding, a phase-in plan was implemented to meet the financial goals of the fund. Initial prefunding only factored employees with at least ten years of service. Based on a policy decision by the LACERS Board, in July 2006, the City began making contributions for all employees regardless of years of service.

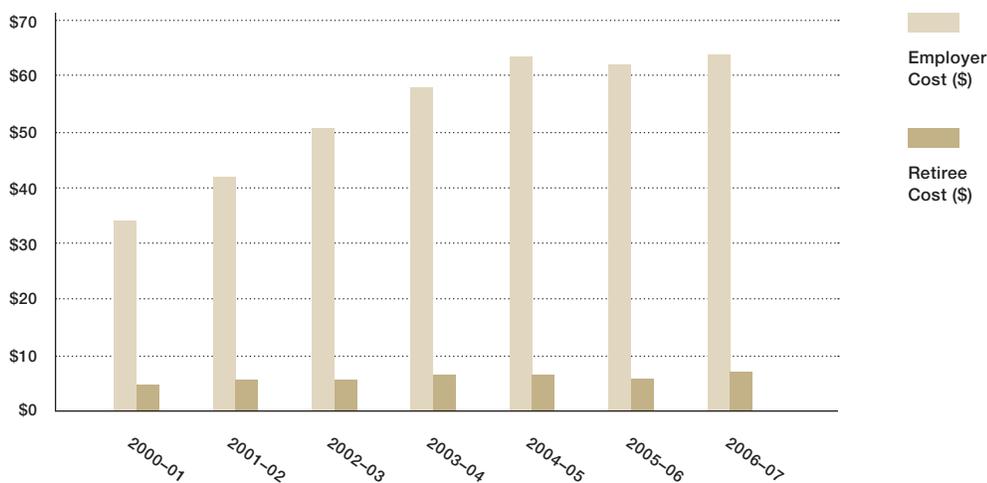
The City's motivation for creating the Post-Employment Healthcare Plan stemmed from the City's Administrative Office and its interest in

addressing OPEB obligations in a financially prudent manner. In Los Angeles, the City's Administrative Office is the chief negotiator with employee groups. Prefunding was presented as an avenue to address rising employment costs and ensure future obligations would be met in a fiscally prudent manner. Employee groups and the retirement system supported the prefunding plan to ensure that benefits are available for future retirees.

The Post-Employment Healthcare Plan is administered by LACERS. Since the plan is enabled through statute, the City makes the actuarial determined annual required contribution (ARC) to the Post-Employment Healthcare Plan every year. The City currently contributes 6.25% of payroll for all City employees that are a part of LACERS. This contribution will be 5.19% in the next fiscal year.

The Post-Employment Healthcare Plan currently has assets totaling \$1.34 billion, 12% of LACERS' total assets. The LACERS Healthcare Plan is considered 68.5% funded as of the actuarial valuation completed in 2007.

CHART 4:
Costs Paid for Health Care Premiums (*In millions*)



1 The retiree's dependents can be covered, up to the maximum amount of the subsidy.

2 This applies to single-party plan rate. The formula differs if dependents are also to be covered.

Case Study Profile: Foster City

Type of Agency:	City
Number of Employees:	251 Active Employees; 168 Retired Employees
Revenue:	\$26,482,018 (2004/05)
Total Payroll:	\$18,171,347 (2004/05)
Participates in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Minimum of 5 years of service and retirement from CalPERS at a minimum age of 50.

Background

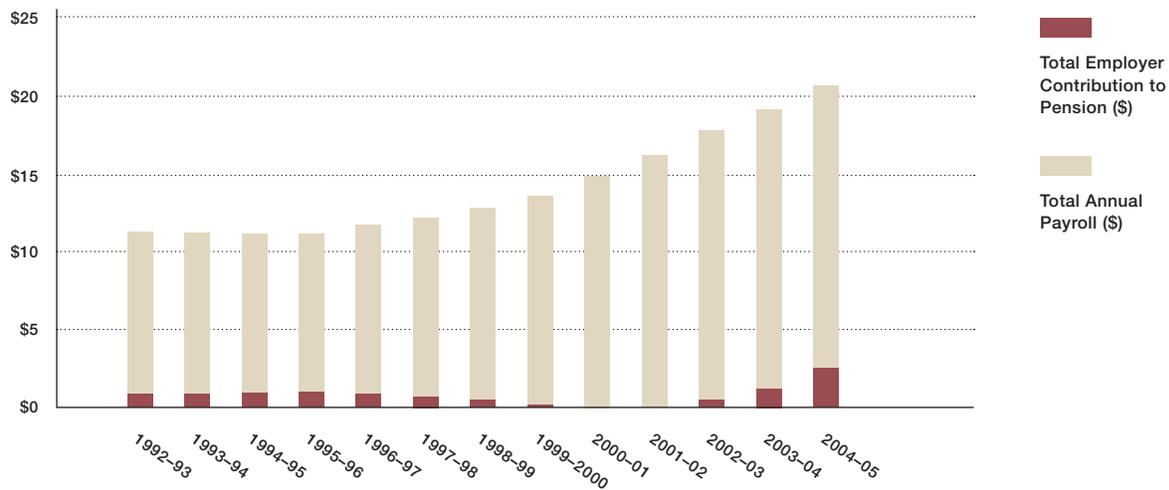
Incorporated in 1971, Foster City is located in San Mateo County with a population of 29,500. Development of Foster City was initiated by the Estero Municipal Improvement District, created in 1960 by the California State Legislature as a general-purpose district with municipal powers to give private developers the “unlimited ability” to sell municipal bonds to finance infrastructure development. The District issued over \$80 million in bonds to provide the infrastructure for a new master-planned community built on a dairy farm and salt ponds near the San Francisco Bay. Foster City is a general law city with a city council/manager form of government. With median home prices of

\$900,000, property tax is the main source of revenue for the City, making up 40 percent of General Fund revenue. Since 1980, several major commercial and industrial developments have been completed, adding a substantial daytime population and providing employment opportunities for City residents.

Pensions

Since its development as part of the Estero Municipal Improvement District, Foster City has been a participant in the California Public Employees Retirement System (CalPERS) for pension benefits. To be eligible for a pension benefit, CalPERS requires

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



five years of service credit under any CalPERS-participating employer, and employees can retire as early as age 50.

Foster City’s current benefit formula is “2% at 55” for all miscellaneous (general) employees, which has been in place since October 1983. The “3% at 50” benefit formula has been provided to fire employees since July 2001 and to police employees since July 2002. Foster City does not participate in Social Security, so its retirees do not have the Social Security benefit in retirement unless they have earned it from service with another employer. Employees hired after 1986 are subject to mandatory Medicare coverage,

while those hired prior to 1986 do not have Medicare eligibility through their employment with Foster City.

As demonstrated in *Charts 2* and *3*, historical pension costs for the City, as represented by total employer contributions, range from zero to 11.82% of the City’s total operating budget. Employer pension contributions have also ranged from 0% to 13.71% of annual payroll costs.

Like all public employers participant in CalPERS, annual employer contributions are determined by actuarial valuations conducted by CalPERS. In 1998/99, employer contributions decreased 89% in

recognition of the increased earnings of the CalPERS funds. In the fiscal years 2000/01 through 2001/02, the City made no contributions to the PERS pension system. Foster City was subject to the employer contribution holiday granted by the CalPERS Board as a result of being superfunded. Since Foster City resumed making contributions to CalPERS in 2002/03, employer contributions grew from 1.15% of its total operating budget to 11.82%, an increase of more than 10 percentage points. From 2002/03 to 2003/04, the employer contribution increased 109%

as a result of negative earnings for the CalPERS funds in response to the stock market downturn in the early 2000s.

Retiree Health Care

The City is a participant in the CalPERS health benefits program, PEMHCA. PEMHCA generally requires that employers contribute the same amount for both active employees and retirees. Since July 2001, the City had been in negotiations with

CHART 2:
Employer Pension Contribution as a Percentage of Operating Budget

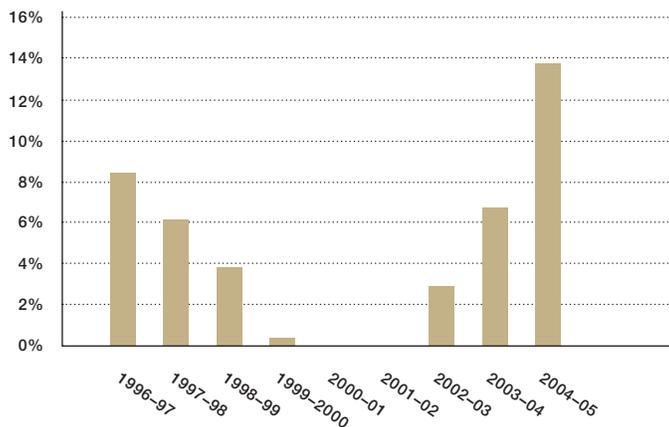
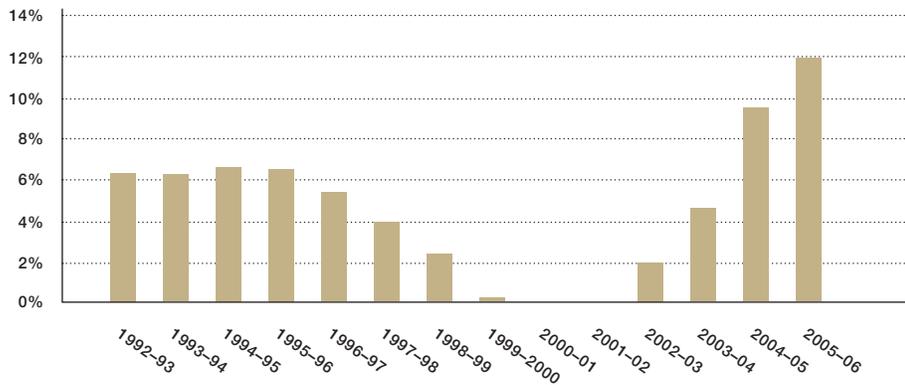


CHART 3:
Employer Pension Contribution as
a Percentage of Annual Payroll

bargaining groups over rising health care costs. To address the rising cost of health care coverage, the City set its employer contribution for active employees at the minimum CalPERS contribution amount, currently \$80.80 per month, which is provided to both active employees and retirees. (The minimum employer contribution level will be raised in 2008 to \$97.00 and will be tied to an inflation formula thereafter.) In addition, the City set up flex benefits to augment the employer contribution amount available for active employees.

By July 2001, several employee groups had attempted to bargain retiree health care during labor negotiations but had been unsuccessful. The City rejected such proposals because of the unrestricted cost of such benefits and the sentiment that City revenue was for active employee salaries and benefits as well as for providing government services.

Understanding that health care costs would continue to rise and in consideration for the valuable service provided by employees, the City began to research alternatives to assist retirees with their health care needs. The major emphasis for this endeavor was the rising cost of health care and the limited likelihood that the City would agree to additional commitments to retiree health care beyond the PEMCHA minimum contribution. At that time retiree health care was an unknown expense and discussions

regarding unfunded liabilities were just being brought to light by the GASB rulings. After extensive research, Foster City concluded that a Voluntary Employees' Beneficiary Association (VEBA) Trust was the possible answer to the retiree health issue for its employees.

The California Governmental VEBA (CGVEBA), a multi-employer VEBA trust, was created by Foster City in 2003 to provide VEBA benefits for its employees, and well as to the employees of any other public agency in the State of California that wishes to participate. City staff worked with benefits consultants and attorneys to develop the plan and trust documents for the VEBA, while the IRS filing and approval process was handled by City staff.

Foster City's decision to create a VEBA was based on the flexibility that the VEBA provided and the opportunity to structure a product that was specifically designed with the public sector employer in mind. Because a VEBA must be collectively bargained, the benefits provided in a VEBA plan can be tailored to meet multiple needs within an organization and for a variety of organizations under the same trust.

The VEBA's investments are managed by MetLife, which created a unique product for the CGVEBA. MetLife guarantees a 3% return, which is used to

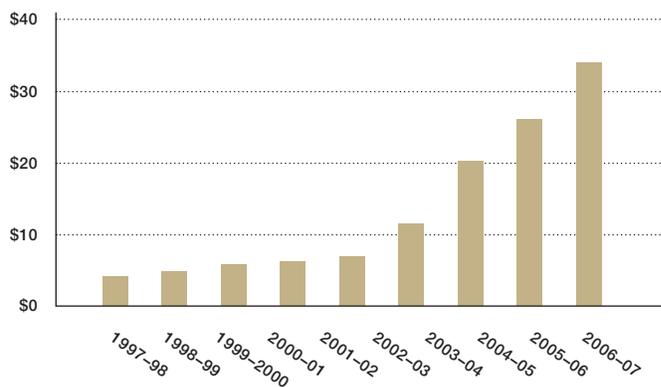


CHART 4:
Premium Costs Paid by Employer for Active Retired Employees
(in thousands)

cover plan administration. There is currently \$3 million in the CGVEBA, and the actual rates of return have been 3.1%, 4.27%, and 5.17% for the first three years of investments. The Administration Resources Corporation is the plan administrator, and Brentwood LLC is the trust administrator. At this time, the Human Resources Director for Foster City serves as the sole trustee until the trust implements a trust committee.

Since the creation of the California Governmental VEBA, three additional agencies (Cities of Hayward, Galt, and Emeryville) have joined and are offering a VEBA program to their employees. As illustrated in *Chart 5*, the VEBA account increased 52.9% in the 2nd quarter of 2006, when the other three public employers joined the VEBA.

Both employee and employer contributions may be made to the VEBA. The City does not currently make any contributions on behalf of its employees.

City employees contribute an amount the City negotiated with the unions for health care costs in retirement. There are no limits on contribution amounts. All of Foster City's bargaining units participate in the VEBA. The City reports that retired employees have been instrumental in talking to active employees about the benefits of having a VEBA account to draw from during retirement. Unions have also been instrumental since the bargained nature of

the VEBA requires the VEBA to be conceived within that structure.

Active and retired employees can receive reimbursements from the VEBA for health care expenditures as long they have a balance in their VEBA account.

Foster City identified the following lessons learned from their experience setting up a VEBA:

1. *Start-up nature of investment accounts.* One of the drawbacks to the CGVEBA is common to many young investment accounts. Due to the start-up nature of a fund with limited assets, it is difficult to produce a return on investment that will grow assets rapidly.
2. *Need for third-party administration.* The City acknowledges that the advantage of a VEBA trust is having third-party administration. This eliminates many of the employer's administrative obligations such as reviewing requests for reimbursement, making payments, and meeting government reporting requirements.
3. *IRS considerations.* Under current rules, all members of a bargaining unit or association must participate in the VEBA at some level determined by the bargaining unit/association via negotiation with the employer. Employees cannot elect to participate on an individual basis. A VEBA is

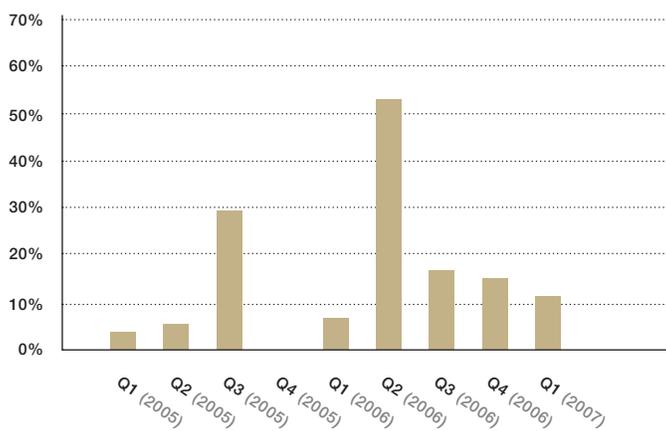


CHART 5:
Growth of Assets in the CGVEBA by Rate of Increase

required to be collectively bargained by law. This is not a barrier for public employers given the history of bargaining health and welfare benefits. One major incentive for employee participation is that any contribution made to a VEBA account is done on a pre-tax basis and any reimbursement is received without taxation.

4. *Public employer control.* Foster City created a benefit program that the public sector owns and operates. A major advantage of the CGVEBA is that the VEBA trust development and operation takes into account the problems and issues any public agencies face. As a result, flexibility is critical and “one size does not fit all”. As an example, the CGVEBA operates under a broad plan design. The plan refers to any of the options allowable under the IRS and does not place specific limitations on them. Where other products are limited to employer only contributions or a contribution from sick leave conversion, the CGVEBA permits both employee and employer contributions and contributions from leave conversion. All such contributions are permissible under the IRS code for VEBAs. As employer and employee needs arise the provisions of the VEBA may change through negotiation.

The City has decided to continue funding retiree health benefits on a pay-as-you-go basis, but it has limited its overall liability by paying only the minimum employer contribution for retiree health benefits required by PEMHCA.

Case Study Profile: City of Fresno

Type of Agency:	Charter City
Number of Employees:	3,413 Active Employees, 2,153 Retired Employees
Revenue:	\$1,072,553,700 (2006/07)
Total Payroll:	\$193,871,273 (2006/07)
Participates in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Five years of service and qualify for retirement

Background

Unlike many of the major cities in the San Joaquin Valley, the City of Fresno was not established as a result of the California Gold Rush of the 1850s. In 1872, the Central Pacific Railroad was constructed through the San Joaquin Valley. It created a station named “Fresno Station”, and since it was the only rail station in the area, people gravitated to that location. The City of Fresno was first incorporated in 1885. By 1900, the population reached 12,470 and the first city charter was drafted. The population of the City of Fresno reached 481,000 on July 1, 2007. It is the largest city in the Central Valley.

Pensions

As the city’s charter and its municipal code, the City of Fresno provides two separate pension systems: the Fresno City Employees’ Retirement System, which has 2,319 active members and 1,256 benefit recipients; and the Fresno City Fire and Police Retirement System, which has 1,097 active members and 819 benefit recipients. Each pension system has its own separate board of trustees.

Fresno City Employees Retirement System

Non-safety permanent city employees are provided with a pension benefit that equals 2% per year of service for the first 25 years plus 1% per year

thereafter, multiplied by the average of the highest compensation for three consecutive years. The Fresno City Employees' System has a minimum retirement age of 55, requiring at least five years of service to earn a benefit.

Fresno City Fire and Police Retirement System

The Fresno City Fire and Police Retirement System has two tiers of benefits.

- Tier 1—Members receive 2.75% per year of service up to age 50, not to exceed 20 years, plus 2% per year of service after age 50, not to exceed 10 years, multiplied by final compensation. Final compensation is determined by the average of the compensation earnable over the highest three consecutive years using today's pay, rather than the pay actually earned. Tier 1 has a 10 year vesting requirement and a minimum retirement of age 50. The maximum benefit is 75% of the final compensation amount used in determining the pension. As a closed tier (no new members allowed after 1990), it currently contains 297 active members and 776 retirees.
- Tier 2—In 1990, the City created a Tier 2 for all new safety employees. In 1998, the City merged the two tiers into a single system to take advantage of the surplus earnings in Tier 1. Tier 2 has a minimum retirement age of 50 and requires 5 years of service to earn a benefit. The Tier 2 benefit is calculated according to the formula that follows.

Under this formula, "final average salary" means the average of the compensation earnable over an employee's highest three consecutive years using today's pay rather than the pay actually earned.

Retirement Age	Tier 2 Benefit Formula
50	2.00% x FAS x YS
51	2.14% x FAS x YS
52	2.28% x FAS x YS
53	2.42% x FAS x YS
54	2.56% x FAS x YS
55 and over	2.70% x FAS x YS

FAS (Final Average Salary)
YS (Years of Service)

There were 800 active members and 43 retirees in Tier 2 as of June 30, 2006.

Chart 1 compares annual employer pension contributions to both systems in proportion to total payroll.

As illustrated in *Chart 2*, since 1990, employer contributions have ranged between 0% (multiple years) and 32.91% (1992/93) of payroll.

Chart 3 shows employer contributions have ranged from 0% (multiple years) to 13.89% (1992/93) of the City's operating budget. In March of 1994, the City issued \$245 million of pension obligation bonds and the proceeds were deposited into the two pension

systems in addition to the normal and unfunded contributions for that fiscal year.

The net asset value of the City Employees' Retirement System was \$945.8 million at market value as of June 30, 2006, and the funding ratio was 139.8%, which represents the thirteenth consecutive year the system has been over 100% funded. The net asset value of the Fire & Police Retirement System

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)

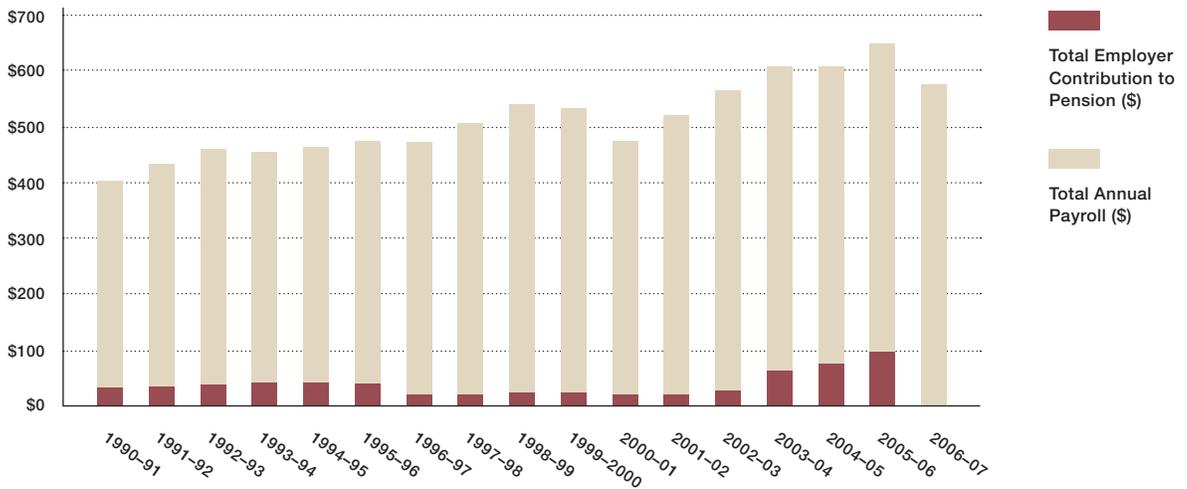
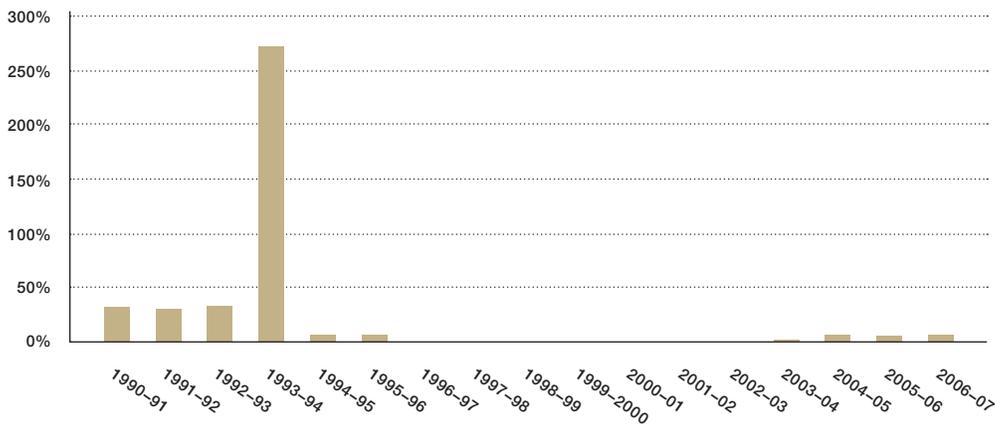


CHART 2:
Employer Pension Contribution as a Percentage of Annual Payroll



was \$1.05 billion at market value as of June 30, 2006, and the funding ratio was 126.4%. The fiscal year ending June 30, 2006 was also the thirteenth consecutive year that the Fire and Police Retirement System was over 100% funded.

The retirement systems remain extremely well funded due to strong investment returns and the stability of benefits. During the past 16 years, only five years had investment returns below the assumed (expected) rates; assets significantly out-performed the assumed rate of return during the other 12 years. Benefits have not changed for the City Employees System since 1970. In 1998, the Fire & Police Tier 1 benefit formula was increased from 2.5% to 2.75% per year of service when the City merged the Tier 2 Fire and Police System into the Tier 1 System.

Investment performance has resulted in a significant number of years in which there was no employer contribution needed for either of the systems. Each year, the Retirement Board may declare a surplus based on the results of the annual actuarial valuation report for each system. The valuation reports determine the net City contribution rates, if the declared surplus is not sufficient to offset the estimated City contribution requirements. For the fiscal year ended June 30, 2007, the City had no cash contribution requirement for the City Employees' System due to the surplus earnings in that system, but the City did contribute approximately \$4.6

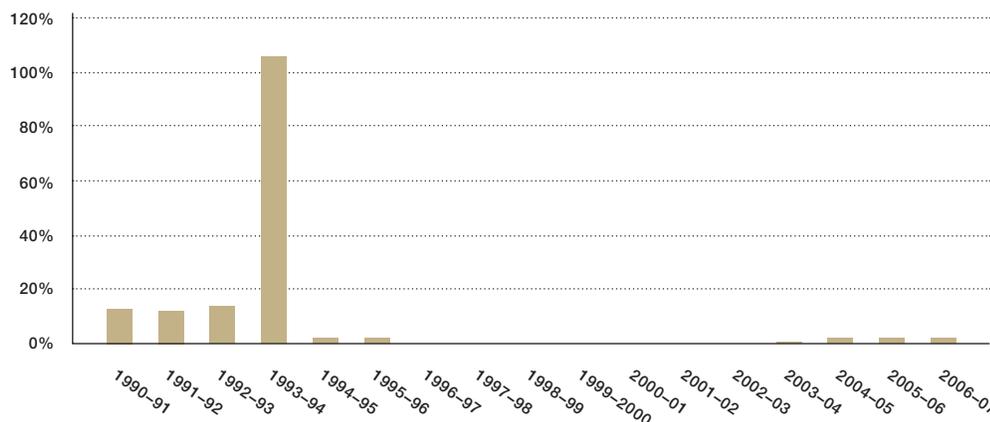
million to the Fire & Police System which represents only 5.38% of the total blended normal contribution rate of 20.02%.

Although the funding ratios for the two Fresno systems have remained strong, like most other public pension systems, the annual normal costs for the systems have increased slightly over time, attributable to the longevity of the population. Twenty-five years ago, the average life span was expected to be in the high 70s; actuaries now estimate a life expectancy into the mid-80s. As a result, pension systems, including those for the City of Fresno, have had to adjust their funding objectives and normal contribution rates over time to allow for the slightly longer lives of their members.

The DROP Program

A Deferred Retirement Option Program (DROP) typically allows a participant who qualifies for normal retirement to file for retirement but then continue working. In Fresno, the participant's monthly retirement check is deposited into a separate DROP account which earns interest along with annual cost-of-living increases. During this time, the employee continues to work and draw his or her full salary. When the participant actually retires and separates from employment (on average four or five years after entering the DROP), he or she is entitled to various distribution options which can include:

CHART 3:
Employer Pension Contribution as a Percentage of Operating Budget



1. a lump sum payment of the balance in the DROP account, plus interest;
2. the conversion of the DROP account balance into an annuity over a fixed period of time;
3. a rollover of the DROP account into an IRA account; or
4. a combination of the above three options.

The City of Fresno is one of only three cities in California to offer both safety and miscellaneous (general) members a DROP program. (The other two are San Diego and Los Angeles.) Most agencies offering a DROP only allow safety members to participate in these programs. The DROP programs were added by the City of Fresno in 1998. At the time, the City was hiring a tremendous number of safety officers and felt a need to retain veteran employees to train new officers and support staff. The city council approved a DROP program for both systems based on a cost neutral design and the ability to adjust the interest crediting rate in order to remain cost neutral. In the City Employees' System, the DROP solved a problem in the service credit formula (2% for the first 25 years and 1% thereafter) by offsetting the 1% reduction for most employees after 25 years of service.

When an employee enters the DROP program, they freeze their benefits at that time and DROP participants do not accrue additional service while in the DROP program. Participants accumulate monthly deposits in their DROP accounts plus interest, plus annual COLA adjustment equivalent to retirees. So, in lieu of additional service credits, the DROP participants accumulate funds in their DROP account and have various distribution options. If DROP participants continued to accrue service and had over 25 years with the City, they would only accrue 1% per year unless over age 55. Therefore, participation in the DROP program can eliminate

the reduction in service credits after 25 years of service for many employees.

It should be noted that the City of Fresno DROP programs have been reviewed by the systems' independent actuary and determined to be cost neutral to the systems. This is unusual among DROP programs. Currently, the City of Fresno systems have a total of 391 DROP participants (169 Fire & Police participants and 222 participants in the City Employees' System).

Retiree Health Care

The City of Fresno offers its retirees the opportunity to participate in the health, dental, and vision plans provided by the City's Health and Welfare Trust. As a result of collective bargaining, the City pays 80% of the monthly premiums for active employees. There is no employer contribution to assist retirees, although there have been a few MOU provisions to allow for the conversion of accumulated sick leave hours into a health reimbursement arrangement (HRA) to pay a portion of retiree premiums for medical insurance.

A Post-Retirement Supplemental Benefit Program (PRSB) was created in 1998. This program provides a contingent benefit to assist retirees with their post-retirement medical costs, but payment of the benefit is subject to surplus investment earnings being available. Since 1999, retirees in both systems have received the PRSB payments. For calendar year 2008, the Fire and Police PRSB payment will be \$420.43 per month, and the City Employees System will be paying \$318.04 per month per retiree.

The only GASB impact to the City is the implied subsidy resulting from retirees' participation in active employee health plans at the same premium rates. The City is currently completing an OPEB valuation through their Finance Department.

Case Study Profile: City of Mountain View

Type of Agency:	City
Number of Employees:	589 Active Employees; 250 Retired Employees
Revenue:	\$207,622,869 (2006/07)
Total Payroll:	\$51,419,469 (2006/07)
Participates in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	For all employees hired before July 1, 2007, a tiered eligibility structure based upon bargained eligibility criteria. For all employees hired after July 1, 2007, 15 years of service and minimum of age 50.

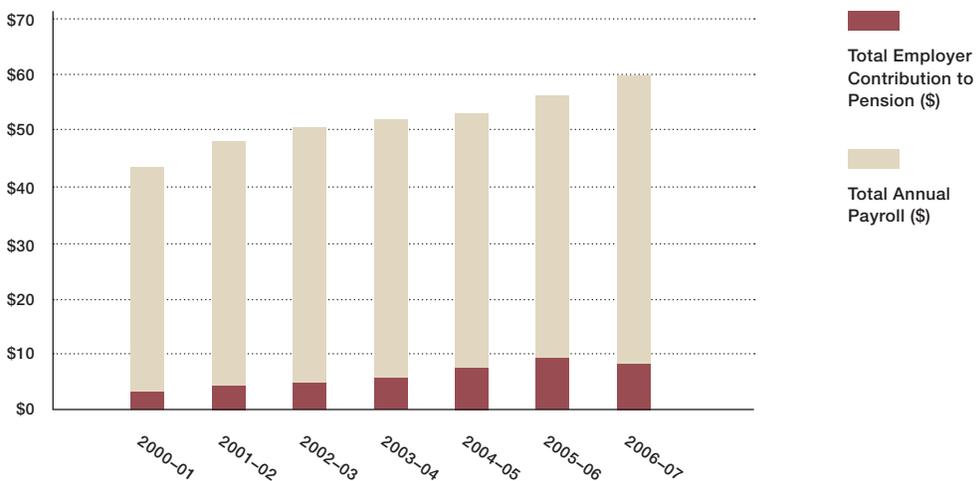
Background

Incorporated in 1902, the City of Mountain View is located in Santa Clara County with a population of 71,995. After World War II, the City's population grew along with the growth of the electronic and aerospace industries, but Mountain View remained predominantly agricultural into the 1960s. Contemporary Mountain View has seen itself transformed from an agricultural town into a high-tech center located in the heart of the Silicon Valley. Mountain View is a charter city with a council/manager form of government. Under this type of government, the city council is the policy-making body, appointing the city manager who is responsible for carrying out council policies and managing the daily operations of the City. General Fund revenue is derived primarily from property tax, sales tax, and other taxes.

Pensions

The City of Mountain View participates in the California Public Employees' Retirement System (CalPERS). The current benefit formula of "2.7% at 55" for all miscellaneous (general) employees was implemented on July 1, 2007 based on negotiations with employee bargaining units. From July 1, 1998 to July 1, 2007, the benefit formula for miscellaneous employees was "2% at 55," and prior to July, 1998 was "2% at 60." As part of bargaining for the "2.7% at 55" formula, miscellaneous employees agreed to share the cost of the resulting increase in the CalPERS employer rate. The formula change from "2% at 55" to "2.7% at 55" increased the CalPERS employer rate by 4.842%, of which employees agreed to pay 3.25%, 2.5%, or 1.5% depending on bargaining unit.

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



The current benefit formula for safety employees is “3% at 50” and was implemented in July 2001 based on negotiations with employee bargaining units. The prior benefit formula was “2% at 50.” As part of the agreement for the “3% at 50” formula, safety employees agreed to share half of the resulting increases in the employer contribution rate for the new formula. The employer rate for the first year under “3% at 50” was 16.268% of payroll. In fiscal year 2006/07, the employer rate was 24.362% of payroll—an additional 8.094% over the previous year—primarily due to the fall in the stock market. The safety employee contribution rate, for both the “2% at 50” and the “3% at 50” formulas, is set in law at 9% of pay. As agreed to during bargaining, safety employees also pay an additional 50% of

the employer contribution when the CalPERS rate exceeds 16.268%. In fiscal year 2006/07, adding half of the new employer cost to the safety employee rate brought the total employee contribution for the “3% at 50” formula to 13.047%.

The pension vesting criteria for all employees is five years of employment with any CalPERS covered employer and retirement at 50 years of age or older. Mountain View does not participate in Social Security.

Chart 1 represents Mountain View’s pension costs as a percentage of total annual payroll. Pension costs have ranged from 8.13% to 19.47% of the City’s total payroll. This chart does not reflect agreed upon cost-sharing by employee.

Chart 2 shows that the employer pension contributions have ranged from 2.98% to 6.20% of the City's total operating budget.

Retiree Health Care

The City of Mountain View offers health care for both its active and retired employees. Benefits available to active employees include health care, dental, vision, death/disability, and life insurance. The City's employer contribution to retiree health insurance covers the retiree only, but dependents of retirees have access to health and vision benefits at their own expense. Active and retired employees are in the same risk pool for purposes of health plan rate setting, creating an implicit subsidy under GASB for allowing retirees access to health benefits at blended rates. The implicit subsidy represents the additional cost of active employee health benefits resulting from the inclusion of retired employees.

The vesting criteria and employer contribution for retiree health benefits varies among bargaining units, with grandfathering provisions in MOUs complicating a summary description the City's retiree health benefit. For most current and future retirees, the City pays 85% of the health plan premium for the retiree only after 15 years of service. Benefit eligibility for all employees requires a retiring employee to be at least 50 years of age and to begin receiving a CalPERS retirement benefit. Employees granted a disability retirement due to a job-related

injury are eligible for the employer contribution regardless of age and years of service. The employer contribution for retiree health benefits is considered "vested" when the eligibility requirements contained in bargaining agreements are met.

Employees who retired prior to 1990 receive 100% of the retiree health plan premium paid by the City after five consecutive years of service.

Current non-safety employees, other than those represented by SEIU, who are covered by the miscellaneous, technical, clerical, professional, and management association MOUs have grandfathered vesting provisions. Tiered vesting was implemented in the mid-1990s, with the following eligibility requirements for the employer contribution indicated as a percent of monthly health plan premiums to be paid by the City:

- 50% of premium for 5 -10 years of service
- 65% of premium for 10 – 15 years of service
- 85% of premium for 15 or more years of service

Alternative Defined Contribution Health Care Plan

As an alternative, a recent employee contract offers the voluntary choice of a defined contribution health plan for new hires. This option provides portability of a personal account for those who leave the City's employ prior to the 15-year vesting of the defined benefit option. Mountain View began offering the option of the defined contribution plan to new

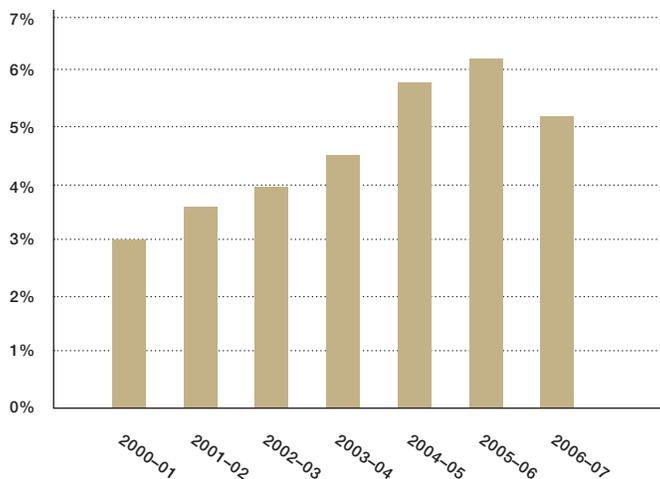


CHART 2:
Employer Contribution as a Percentage of Operating Budget

miscellaneous (general) employees hired on or after July 1, 2007 that are represented by the management, professional, or technical employees association, comprising the majority of non-safety staff. New employees have up to one year to choose between the defined benefit and the defined contribution plan for retiree health care.

For the defined contribution plan, the City pays \$200 per month into a health care savings account for the employee while actively employed. That amount increases with every five years of employment. The vesting requirement is five years of service with the City. Employees must reach the age of 50 before money from the account can be spent for health care costs.

Although this option has not been offered long enough to provide quantified results, the City hopes

it will help to reduce future health care liabilities by reducing the number of employees and future retirees eligible for the defined benefit plan.

As shown in *Chart 3*, total premiums for retiree health care have risen dramatically over the last several years. In 1992, the City conducted its first OPEB actuarial valuation which identified a \$15 million unfunded liability. Mountain View decided that prefunding would be the best way to reduce its OPEB liability.

In 1994, Mountain View set up a special revenue account and began making contributions by transferring money from the General Fund to that account. *Table 1* shows the increasing OPEB liabilities as well as the amounts contributed to the reserve account.

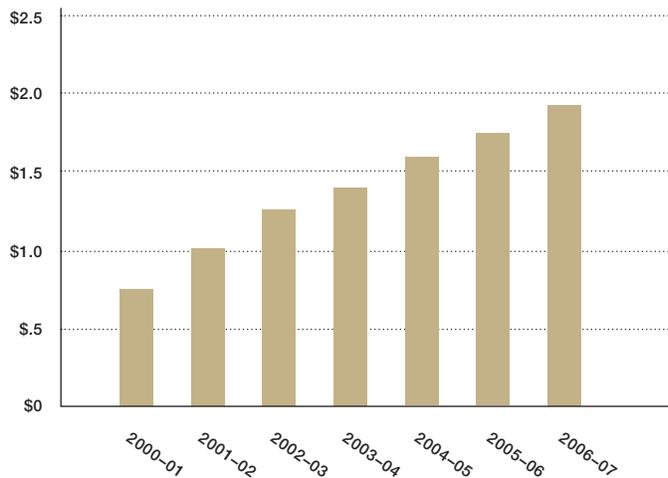


CHART 3:
Premiums Paid for Retiree Health Care
(In millions)

YEAR	ACTUARIAL LIABILITY	RESERVE ACCOUNT FUNDING LEVEL
1992	\$15	\$0.0
1997	\$19	\$4.0
2001	\$31	\$10.0
2004	\$44	\$13.1
2007	\$60	\$32.7

TABLE 1:
City of Mountain View Retiree Health Liability
(In millions)

The City of Mountain View is committed to funding the reserve account for OPEB liabilities and has built this commitment into their budgeting process. In order to ensure that funds are available to contribute to the reserve account, the City of Mountain View budgets its expenditures at approximately 5% less than anticipated revenues. The City notes that this budgeting practice allows it to set aside funds to complete capital projects and to make contributions to reserve accounts, including the OPEB reserve.

In 2007, a new actuarial report identified a \$60 million unfunded OPEB liability with an annual required contribution (ARC) of \$5 million. Although currently using a reserve account in the City treasury, the City plans to set up an irrevocable trust for its

prefunding efforts in order to achieve a higher rate of return and to reduce OPEB liabilities. Mountain View has looked at other funding options and feels the CalPERS trust fund may be the best option to reduce its OPEB liabilities. Since the City does not participate in PEHMCA, establishing an OPEB trust with CalPERS was not an option until Assembly Bill 554 was signed into law by the Governor earlier this year. As can be seen in *Table 2* below, by setting up a trust fund with CalPERS, the City expects to reduce its actuarial liability by \$15.7 million as a result of CalPERS' higher investment earnings assumptions.

Mountain View's OPEB liabilities are currently 55% funded. Once prefunding with CalPERS occurs, the City's OPEB liabilities are expected to be 75% funded.

OPTION	ACTUARIAL LIABILITY	FUND BALANCE
Existing Reserve Account	\$60	\$32.7
CalPERS Trust Fund *	\$44.3 *	\$32.7

TABLE 2:
Comparison of Funding Options
(In millions)

* Reflects PERS Assumptions and Methods

Public Employee
Post-Employment
Benefits Commission

Section I:
City of
Mountain View

Case Study Profile: City of San Rafael

Type of Agency:	City
Number of Employees:	589 Active Employees; 254 Retired Employees
Revenues:	\$66,536,387 (2005/06)
Total Payroll:	\$35,450,962 (2005/06)
Participates in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	5 years of service, minimum age of 50, and retirement within 120 days of separation

Background

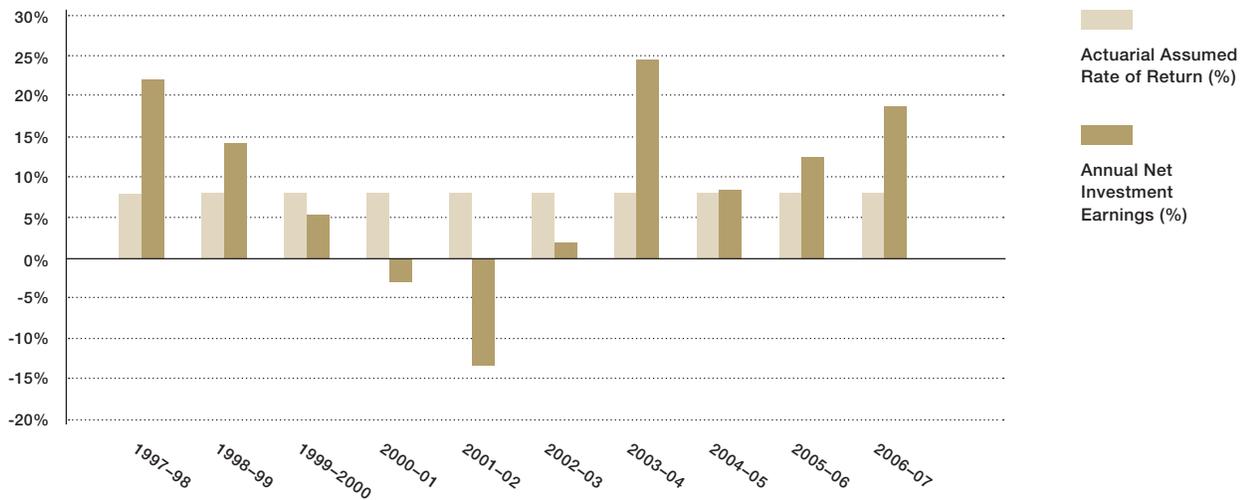
Incorporated in 1874, the City of San Rafael is located in Marin County with a population of 58,047. San Rafael is a charter city with a city council/manager form of government with an elected mayor. Under this type of government, the mayor and the city council constitute a policy-making body, with the city manager responsible for carrying out council policy. Sales and property tax are the largest sources of City revenue, accounting for almost 60% of the budget.

Pensions

San Rafael participates in the Marin County Employees' Retirement Association (MCERA), a retirement system operating under the provisions of the 1937 Act. Since its creation in 1950, MCERA has become a multi-employer retirement system, administering pension benefits for ten agencies, including the County, the City of San Rafael, and a number of special districts.

Chart 1 shows MCERA's net investment earnings over the last seventeen years, with an average return of 9.24% compared to the actuarial assumed rate

CHART 1:
Actuarial Assumed Return vs. Actual Investment Return



of return of 8.25%. This targeted rate of return was lowered to 8.0% at the beginning of the current fiscal year.

According to the most recent actuarial valuation, MCERA's funding ratio is 88%, while San Rafael's retirement plan is 72% funded.

San Rafael has participated in MCERA for retirement benefits for over 30 years. Prior to joining MCERA, the City participated in CalPERS. Retirement pension benefit formulas are set at "2.7% at 55" for

miscellaneous (general) employees and "3% at 55" for safety employees. These formulas were enhanced in 2004 and 2006 as a result of employee bargaining negotiations. The additional cost of the benefit increases are fully borne by the employees.

Employees vest after five years of service and are eligible to receive retirement benefits after 10 years of service and a minimum age of 50, or after 30 years of service for miscellaneous employees (20 years for safety) regardless of age.

As illustrated in *Chart 3*, San Rafael's employer pension contributions have ranged from 4.88% to 14% of the City's total operating budget.

Chart 4 shows that employer pension contributions as a percent of annual payroll costs have ranged from 7.70% to 26.28%. The 2004/05 fiscal year saw a 96.7% increase in employer contributions due to significant declines in the stock market.

Retiree Health Care

San Rafael provides retiree health care benefits to employees. The City contracts with the CalPERS Health Benefits Program, PEMHCA, for retiree health care benefits. The City is currently reviewing its vesting guidelines for retiree health

care. Traditionally, the amount of the employer contribution toward retiree health care benefits has been determined through the bargaining process. The City sets a cap for funding retiree health care premiums, currently ranging from \$386 per month for police, \$557 per month for fire, and \$645 per month for miscellaneous employees. The laws governing PEMHCA stipulate that any retiree with a total of five years of service under a CalPERS-covered employer, who's at least 50 years of age, and retires within 120 days of separation from the City, is eligible for retiree health benefit coverage. As seen in *Chart 5*, the costs of health care premiums have significantly increased over the last five years.

The City funds current retiree health care benefits in a combination of pay-as-you-go and from investment

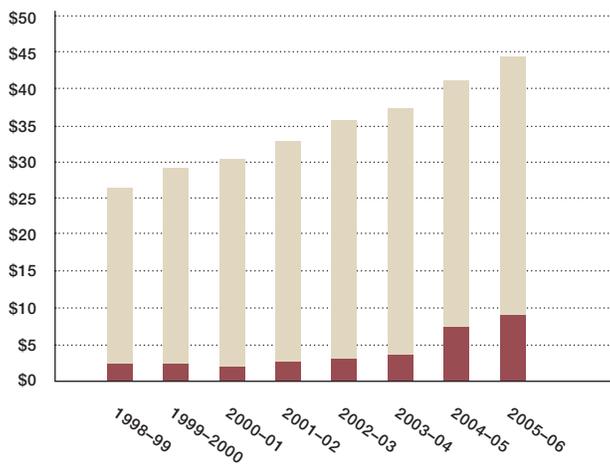


CHART 2:
Employer Pension Contribution as
a Proportion of Total Annual Payroll
(In millions)

■ Total Employer
Contribution to
Pension (\$)

■ Total Annual
Payroll (\$)

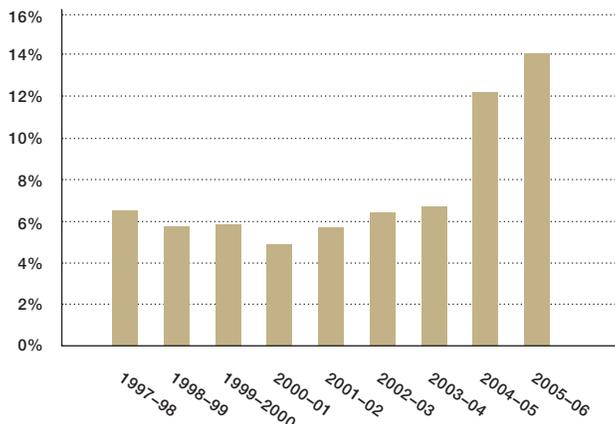


CHART 3:
Employer Pension Contribution as
a Percentage of Operating Budget

returns from a prefunded 401(h) account available through MCERA. Section 401(h) of the Internal Revenue Code permits a pension or annuity plan to provide for payment of benefits for life and disability insurance, sickness, accident, hospitalization, and medical expenses for retired employees, their spouses, and dependents.

A 401(h) account is very similar to a VEBA (voluntary employees benefits association) in that both contributions and withdrawals are tax-exempt. However, a 401(h) account does not need to be set up as part of a bargaining agreement. The maximum allowable employer contribution under a 401(h) plan is 25% of the normal cost of annual contributions to the pension plan. Administrative costs to administer the 401(h) account are charged to the fund balance

and shared pro-rata by the participating agencies. OPEB funds in the 401(h) account are commingled with pension fund assets for investment purposes.

San Rafael began to use the 401(h) account in 1992, and the current account balance is approximately \$12 million. The City is currently completing its actuarial valuation to determine its OPEB liability. San Rafael's 401(h) account in MCERA will be available to offset the liability.

The maximum allowable distribution from the 401(h) account cannot exceed the employer contribution for retiree health benefits. Disbursements are made directly to the insurance carrier (CalPERS in the case of San Rafael) and are monitored and approved by MCERA.

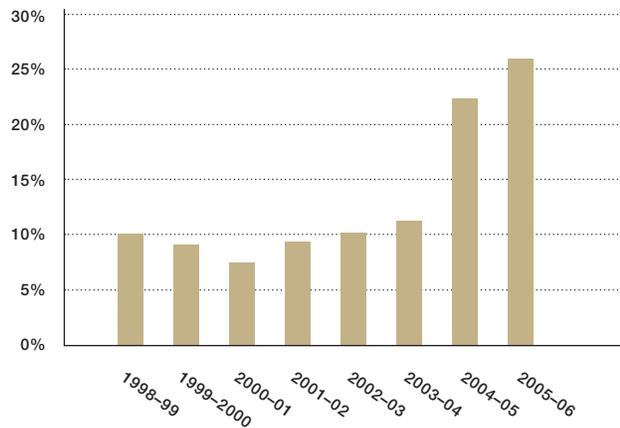
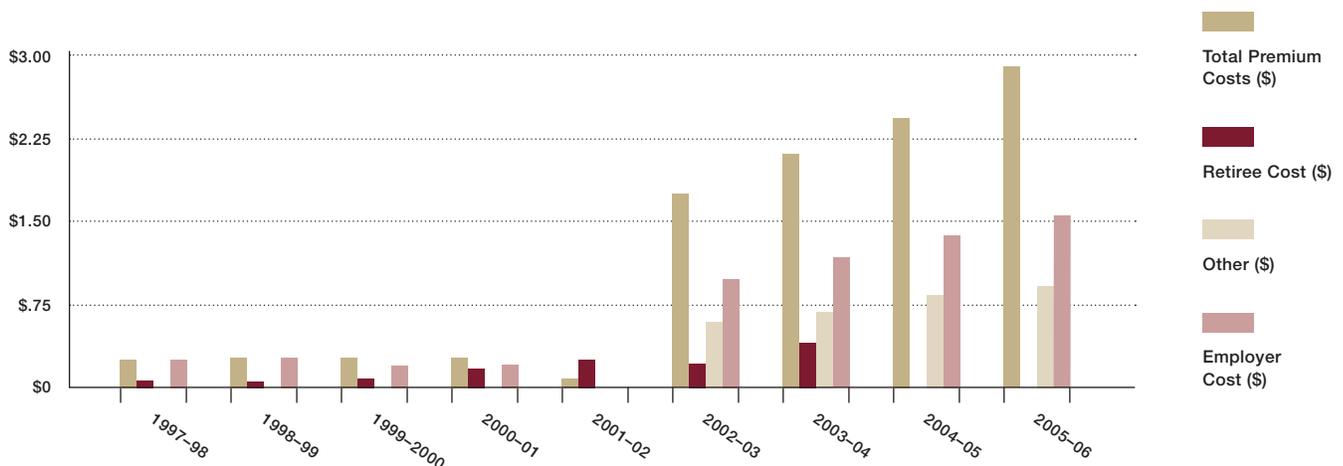


CHART 4:
Employer Pension Contribution as a Percentage of Annual Payroll

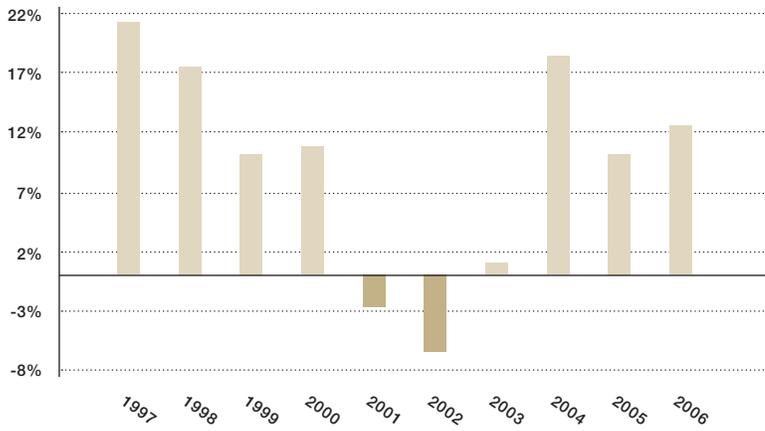
CHART 5:
Premiums Paid for Retiree Health Care (In millions)



Rates of return for the 401(h) plan are presented in *Chart 6*. The fund experienced double digit annual returns, except in the years of the stock market decline in 2001 through 2003.

The City of San Rafael is the only employer participating in MCERA that contributes to an OPEB account.

CHART 6:
Rate of Return on OPEB Investments



Case Study Profile: City of Thousand Oaks

Type of Agency:	City
Number of Employees:	432 Active Employees; 165 Retired Employees
Revenues:	\$135,200,000 (2006/07)
Total Payroll:	\$29,614,861 (2006/07)
Participates in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Five years of employment, direct retirement from City and CalPERS after age 50

Background

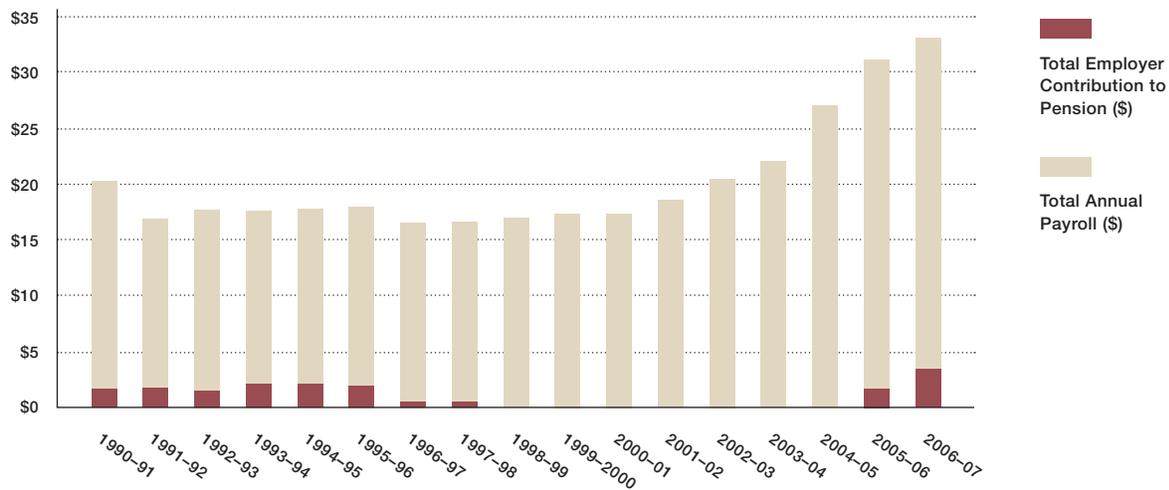
Incorporated in 1964, the City of Thousand Oaks is located in Ventura County with a population of 127,000. Thousand Oaks is a general law city with a council/manager form of government. Under this type of government, the city council is the policy-making body, appointing the city manager who is responsible for carrying out council policy. The City was incorporated without a general municipal property tax. Therefore, General Fund revenue is collected from diverse sources including sales tax, building/engineering permit fees, service charges, transient occupancy tax, and investment earnings.

General Fund sales tax revenue is the main source of income used to operate general government functions, with annual retail sales reaching \$2.6 billion in 2006.

Pensions

The City of Thousand Oaks is a participant in the California Public Employees Retirement System (CalPERS), a multi-employer retirement system. The current retirement benefit formula for miscellaneous (general) employees is “2% at 55.” A previous

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



benefit formula of “2% at 60” was replaced in bargaining negotiations in 1999/00. There are four bargaining groups in the City: general employees, professionals, senior managers and supervisors, and executive managers. In 2005, negotiations changed the final compensation period used in the benefit formula from a three-year average to the highest one year. Thousand Oaks does not employ any safety employees and has contracted with Ventura County for safety services since its incorporation. The vesting criteria for pensions are five years of service credit and minimum of age 50.

Thousand Oaks does not participate in Social Security so its retirees do not have Social Security benefits in retirement unless earned from another employer. The same is true of its older retirees with respect to Medicare. All public employees hired after 1986 contribute to Medicare.

As shown in *Chart 2*, employer contributions to pensions have ranged from zero (for several years) to 13.3% (1993/94) of the City’s annual payroll costs. As shown in *Chart 3*, the City’s pension costs, as represented by total employer contributions, have

ranged from 0% (during various years) to 3.86% (1993/94) of the City’s total operating budget.

In the fiscal years 1998/99 through 2004/05, the City made no contributions to the CalPERS pension system. That was made possible by several years of extraordinary market returns which resulted in the City being superfunded to as high as 138% of the funds needed to pay promised benefits. Due to strong investment returns, the CalPERS Board initiated an “employer contribution holiday.”

A two-year lag in crediting of investment earnings allowed the City to extend its contribution holiday even into the years of the stock market downturn during the early 2000s. In the 2005/06 fiscal year,

the City made its first contribution to CalPERS since 1997. The City’s payment reached \$3.3 million in the 2006/07 fiscal year, doubling from the year before. The contribution rate set by CalPERS was doubled to address the earnings lost due to the market downturn in the early 2000s.

Retiree Health Care

The City of Thousand Oaks contracts with CalPERS for health care for its active and retiree employees under the provisions of the Public Employees’ Medical and Hospital Care Act (PEMHCA). Benefits available to active employees include health care, dental, vision, disability, and life insurance. Retirees

CHART 2:
Employer Pension Contribution as a Percentage of Annual Payroll

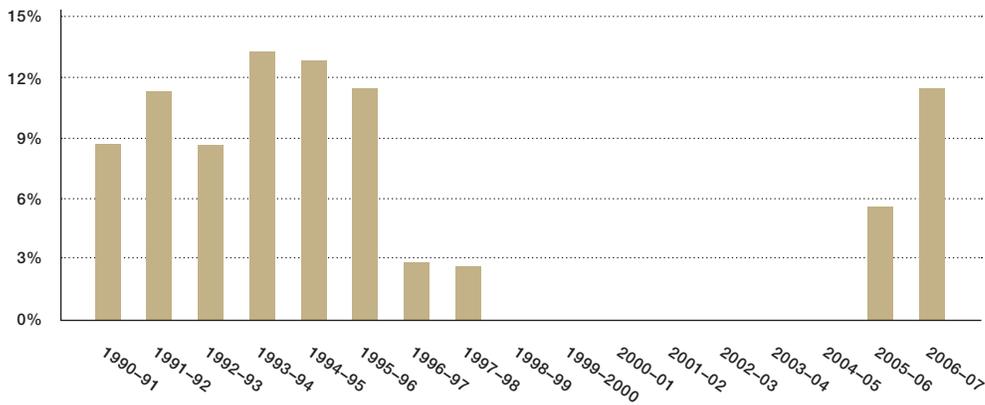
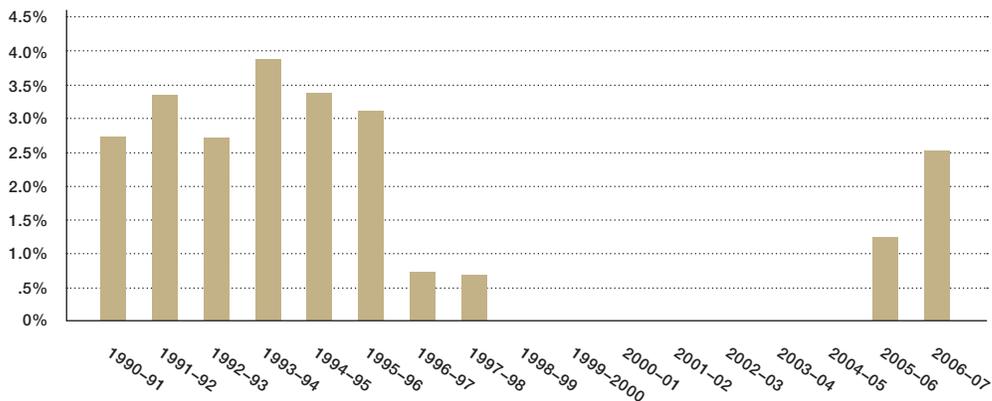


CHART 3:
Employer Pension Contribution as a Percentage of Operating Budget



only have access to health care benefits. Eligibility for retiree health care includes five years of service credit and retirement at a minimum age of 50. The employee must also retire from the City within 120 days of separation from employment. Retiree health care benefits are considered vested due to both statute and bargaining agreements with employee groups.

As participants in the PEMHCA program, both active and retired employees are in the same cost pool for health care. *Chart 4* presents the premium costs paid by the employer for retirees only. As seen in the chart, the employer cost for retiree health care benefits has increased dramatically over time.

Until 2001, retirees received the same employer contribution as active employees, which was \$400

per month. Due to rising health care costs and in recognition of OPEB liabilities, the City set a cap on the employer contribution at \$435 per month beginning in 2001. Any difference between the actual costs of the medical insurance premium and the \$435 is borne by the individual. The City also established a cafeteria plan for active employees, which can be used to pay the difference between more expensive health plan premiums and the \$435 employer contribution.

In 2006, the City conducted an actuarial valuation that identified a \$22.8 million unfunded OPEB liability using a 4% discount rate. Beginning in September 2006, City staff reviewed options for funding the retiree health care liability. One of those options was prefunding through an independent trust fund.

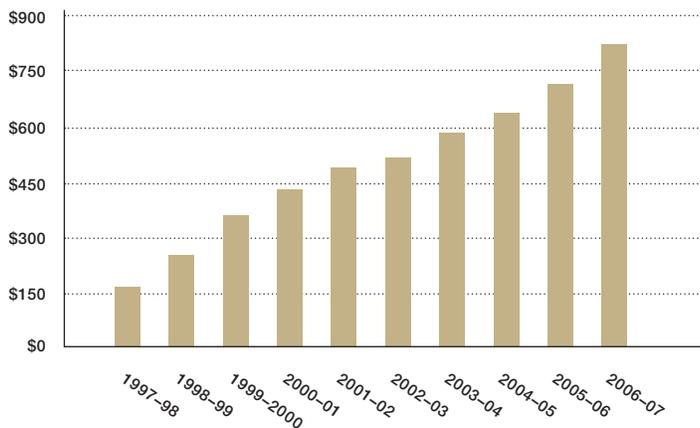


CHART 4:
Premium Costs for Retiree Health Care
(In thousands)

METHOD OF FUNDING	DISCOUNT RATE	ANNUAL REQUIRED CONTRIBUTION (ARC)	UNFUNDED LIABILITY
Pay-as-you-go (Annual normal cost: \$0.9 million)	4%	\$1.5 million, increasing over time	\$22.8 million
Prefund at \$6 million (well above normal costs and ARC levels)	7.75%	\$1.13 million, remaining stable	\$17 million

TABLE 1:
Results of January 2007
Actuarial Study

In January 2007, another actuarial study discussed the possibility of prefunding to address OPEB liabilities. *Table 1* the study explored prefunding at different levels such as at normal costs versus at above normal costs. According to the study, prefunding would reduce the City's OPEB liability to \$17 million, which is a decrease of \$5.8 million from the \$22.8 million identified in the previous valuation. This reduction factored in a higher "discount rate" assumption available to employers who prefund. At the time of the study, current pay-as-you-go costs were at \$0.9 million per year. The study found that creating a trust and initially prefunding it at \$6 million would create an annual required contribution (ARC) of \$1.13 million.

Based on the results of the actuarial study, the City realized that prefunding a trust with a substantial amount of money would significantly reduce its OPEB liability and future ARC payments. Without prefunding, the accrued liability would continue to grow in future years. The City also considered that prefunding would reduce future reported liabilities, potentially resulting in higher bond ratings.

A number of companies offered prefunding plans to the City in response to GASB 45. The City concluded that the CalPERS plan was the best option due to the advantage gained by CalPERS' management of a large number of assets, historical rates of return, investment diversification, and lower administrative costs.

CalPERS Employers' Retirement Benefits Trust Fund

The City of Thousand Oaks was the first government employer to enroll in the new prefunding plan administered by CalPERS. The California Employers' Retiree Benefit Trust Fund was established in March

2007 to provide California public employers with an investment vehicle for prefunding future retiree health insurance and other post-employment benefit (OPEB) costs.

The fund is self-supporting, with earnings to agencies reported as net of administrative fees. The fund is subject to the same actuarial assumed rate of return of 7.75% as the CalPERS Public Employees' Retirement Fund (PERF). The Retirement Benefits Trust does not use the same asset allocation as the PERF, specifically to avoid illiquid investments. Because the size of the new trust is relatively small with a potential for numerous transactions (both contributions and withdrawals) over a short time frame, it is necessary to maintain an appropriate level of liquidity. Consequently, the initial asset allocation approved by the CalPERS Board does not include assets such as hedge funds, private equity, or other alternative investments which cannot be liquidated on a short-term basis.

There is no minimum contribution for public employers to participate in the CalPERS plan and employers can make withdrawals from the fund as needed.¹ Other public employers that participate in the plan include the cities of Milpitas, El Cajon, and Dublin. AB 554 (Hernandez) was recently signed into law, allowing all public employers to participate in the trust fund.

The City of Thousand Oaks has made the largest contribution to the fund to date, with \$6 million as its initial contribution. Funding for the initial contribution came from funds set aside to start to address OPEB liability. The cost of OPEB liability has been built into user fees. All future contributions to the OPEB trust will be in accordance with the City's actuarially determined annual required contribution (ARC) rate.

¹ The original agreement for the CalPERS prefunding plan required any participating agency to leave funds in their account for at least three years. After this period, the agency could withdraw funds as needed. The City of Thousand Oaks entered the program when this requirement was in place. This requirement has since been modified to allow an agency to make withdrawals without any minimum time period for the funds to be on deposit.

Public Employee
Post-Employment
Benefits Commission

Section I:
City of
Thousand Oaks

County Profile: Alameda County

Type of Agency:	County
Number of Employees:	10,514 Active Employees; 6,591 Retired Employees
Revenue:	\$2,200,000,000 (2006/07)
Total Payroll:	\$577,600,000 (2006/07)
Participates in Social Security?	Yes (Safety and Miscellaneous Employees)
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Retirement after attaining the age of 50, with 10 years of qualifying service; retirement at any age, with 30 years of qualifying service; or retirement after attaining age 70, regardless of service credit.

Background

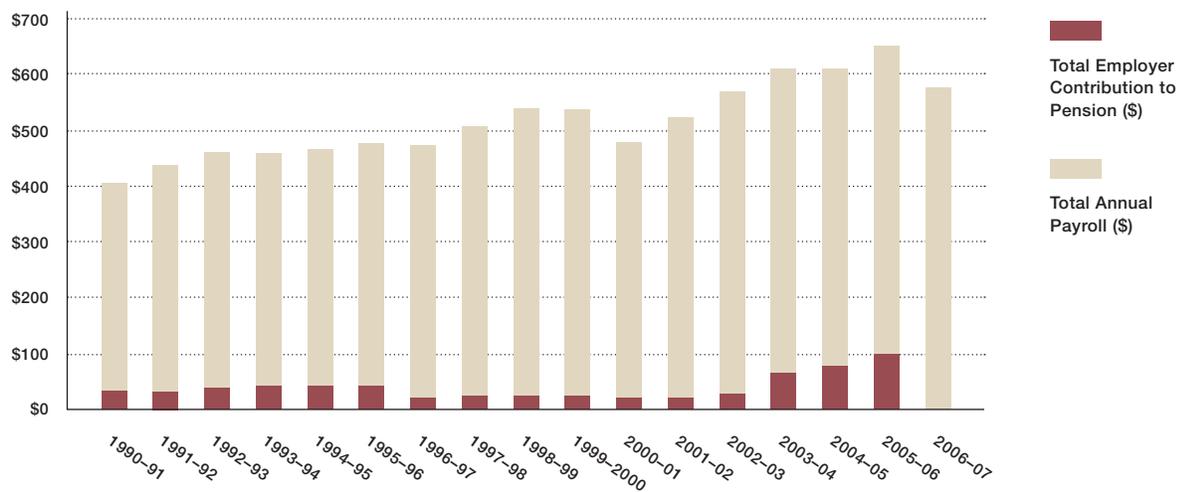
Alameda County was formed in 1853 from portions of Santa Clara and Contra Costa Counties. The population exceeds 1.5 million, making it the seventh most populous county in California. Alameda County possesses a large and diverse economic base, consisting of research and technology, professional services, manufacturing, farming, finance, transportation, wholesale and retail trade, higher education, medical and health services, and government services. Oakland is the largest city in the County, with a population of nearly 420,000, and is the administrative seat of county government. The County operates under a home rule charter adopted

by local voters. Policymaking and legislative authority is vested in the County's Board of Supervisors, which consists of an elected supervisor from each of the County's five districts.

Pensions

The County of Alameda established its own retirement system as authorized by the County Employees' Retirement Law of 1937. (Please see the case study introduction for additional information on the 1937 Act.) The Alameda County Employees' Retirement Association (ACERA) is a multi-

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



employer defined benefit plan for employees of Alameda County, the Superior Court of California for Alameda County, and five special districts located in the County. All risks and costs are shared by the participating entities. Assets are pooled, but an individual employer’s contribution rates can be reduced by the use of pension obligation bonds or other mechanism to reduce its portion of the unfunded liability.

All assets are available to meet ACERA’s ongoing obligations to plan participants and beneficiaries. In calendar year 2005, net assets held in trust for pension benefits increased by \$296.8 million, or

6.9%, primarily as a result of positive market gains, with total net assets of \$5.2 billion as of December 31, 2006. Benefit payments for 2005 totaled \$209.9 million, representing an 11.2% increase over 2004.¹ As of December 2006, ACERA’s funded ratio was 85.5%.²

There are two tiers in ACERA’s pension system. Tier I offers “3% at 50” for safety employees and “2.62% at 62” for miscellaneous employees. Benefits are calculated using a final compensation period of the highest single year. Tier I is closed to employees hired after 1983. Tier II offers “3% at 50” for safety employees and “2.09% at 62” for general employees.

Benefits are calculated using a 36-month average for final compensation. There are currently 6,800 members in Tier II.

Vesting for pension benefits requires the member to: (1) retire after attaining the age of 50, with 10 years of qualifying service, (2) retire at any age, with 30 years of qualifying service, or (3) retire after attaining the age of 70, regardless of service credit.

Chart 1 shows Alameda County's pension contribution as a proportion of its total annual payroll.

Chart 2 illustrates that during the past decade employer contributions have ranged between 4.12% (2001/02) and 16.85% (2006/07) of payroll. In 2003/04, the County experienced an increase of

127% in its employer contributions to the pension fund. The dramatic increase was in response to a drop in investment earnings caused by the economic downturn in the stock market in the early 2000s.

Chart 3 shows that pension contributions have constituted between 1.14% (2001/02) and 4.42% (2006/07) of the County's operating budget.

Overall, ACERA's actual investment earnings have ranged between -7.29% (2002/03) and 25.46% (2004/05). *Chart 4* provides historical rates of return for ACERA. In fiscal year 2006/07, the fund generated 13.64% in earnings. Investment gains and losses are smoothed over five years. Gains and losses are recognized in the employer contribution rate on an annual basis.

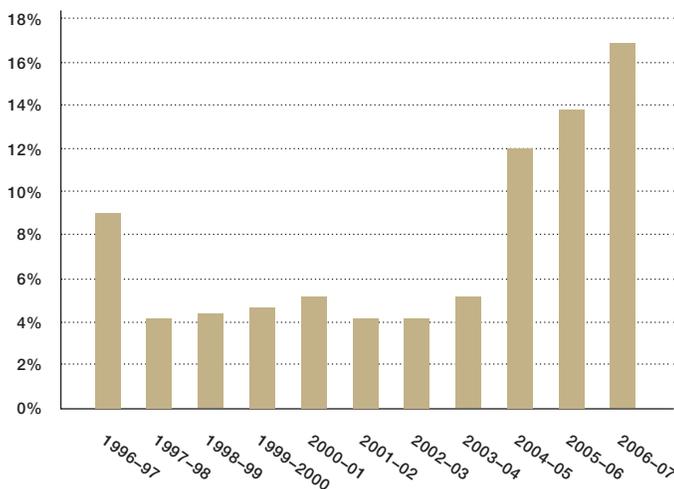


CHART 2:
Employer Pension Contributions as
a Percentage of Annual Payroll

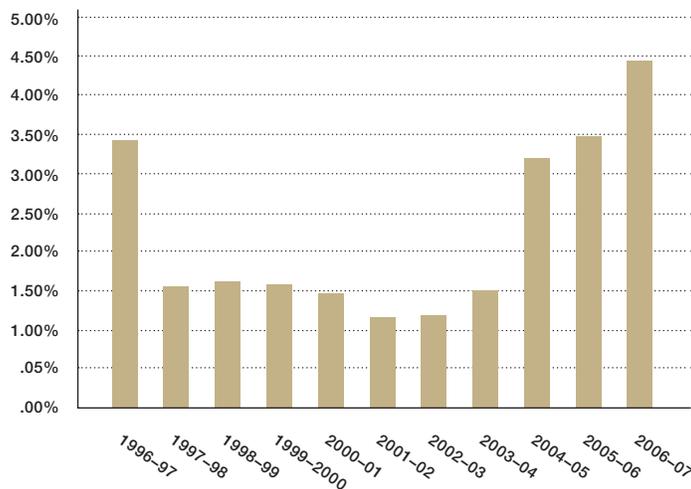


CHART 3:
Employer Pension Contributions as
a Percentage of Operating Budget

Retiree Health Care

ACERA administers a medical benefits subsidy program for retired members and their eligible dependents. The County negotiates medical contracts with providers covering both active and retired members, which results in blended medical premium rates, allowing retirees not yet eligible for Medicare to purchase health coverage at the same premiums paid by active employees.

Retiree health care is not a vested benefit in Alameda County. Retirees instead receive a monthly medical allowance from ACERA to subsidize health care premiums. Members with at least ten years of service,

or those who retire due to a job-related disability, are eligible to receive the monthly medical subsidy.³ The subsidy is based on the lowest average cost medical plan available among contracts negotiated by the County. The actual amount of the subsidy depends on the retiree's number of years of service. The subsidy ranges from 50% for retirees with 10 years of services to 100% for retirees with 20+ years of service. The Board of Retirement approves the annual adjustment (if any) to the subsidy.

Chart 5 provides a historical view of the cost sharing for health care premiums between ACERA and county retirees.

CHART 4:
Actuarial Assumed Return vs. Actual Investment Return

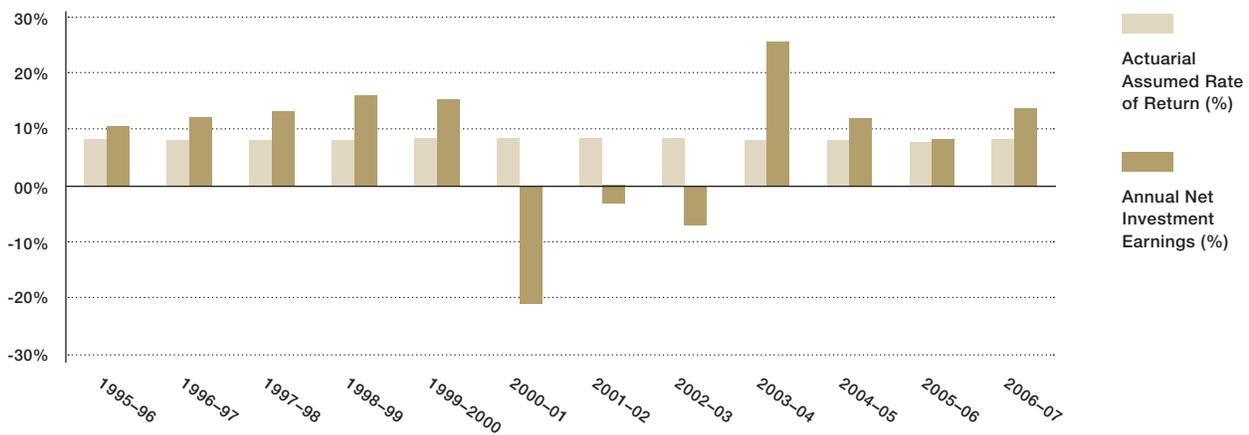
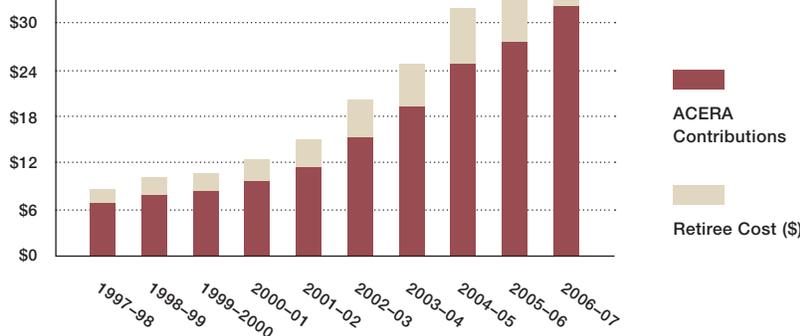


CHART 5:
Health Care Premium Costs
(In millions)



All OPEB funding is through ACERA's Supplemental Retiree Benefit Reserve (SRBR). This reserve funds supplemental benefits for retirees, which currently include health care insurance subsidies, a supplemental COLA, Medicare Part B reimbursement, vision benefits, dental benefits, and increased death benefits.

The SRBR was established on January 1, 1985, upon ACERA's adoption of Article 5.5 (Government Code Sections 31610-31619) of the 1937 Act. ACERA is one of three counties (Alameda, Kern, and Tulare) that have adopted the alternative funding provisions contained in this article. Article 5.5 provides a structured mechanism for sharing annual investment earnings that exceed the actuarial value of assets. Under these provisions, 50% of excess earnings, after meeting funding requirements for various reserve accounts required by law, are placed in a special reserve (the SRBR) to be used only for the benefit of retired members and their beneficiaries.

The law grants discretionary authority over the use of the SRBR funds to the Board of Retirement. The payment of supplemental benefits from the SRBR is subject to available funding and must be periodically reauthorized by the Board. In 2006, the Board of Retirement approved the allocation of SRBR funds to retiree health benefits and to other non-OPEB benefits (supplemental COLA, death benefit, and active death equity benefit), in the amounts of \$449.1 million and \$62.8 million, respectively.⁴

In addition, when GASB 45 was released, the County began discussing options to eliminate the implied subsidy portion of OPEB liabilities. "In order to eliminate this liability, it would have been necessary to no longer provide retirees with access to the health plan rates paid by active employees." In order to prevent this from occurring, ACERA negotiated an arrangement with the County on behalf of retirees whereby ACERA provides an annual reimbursement to the County from the SRBR in the amount of the implied subsidy liability. In exchange, retirees are

able to preserve access to the County's health plan at much lower costs than if a health plan for retirees were separately priced.

In accordance with Article 5.5, ACERA semiannually credits 50% of the balance of net excess investment earnings to the SRBR and the other 50% is credited to employer and member reserve accounts. Federal tax rules require that retiree health benefits are paid through a 401(h) account with contributions from the participating employers. The retirement system cannot directly pay for retiree health care premiums. After the employer contributions are made to the 401(h) account, ACERA transfers an amount equal to those contributions from the SRBR to an employer reserve which can be used to supplement the employer pension contribution. When health care contributions are made in this manner, they are made on a pre-tax basis for the retiree. If ACERA were to provide a direct health care subsidy to its retirees, it would be taxable income for the retiree.

There is no requirement or guarantee that employers will continue to contribute to the 401(h) account, and ACERA's Board of Retirement has no authority to demand future funding from employers. These post-employment benefits will continue to be paid via excess earnings as long as assets are available for that purpose.⁵

The most recent actuarial valuation for the OPEB liability was completed for December 31, 2005. The valuation determined that the OPEB benefits were 79.1% funded. The actuarial value of assets was \$449,119,000; while the unfunded actuarial OPEB liability was \$118,838,000. The SRBR is considered to meet GASB guidelines and has sufficient funds to continue providing the retiree health care subsidy and the supplemental COLA and death benefits program through the year 2023. The County, as the employer, has no OPEB liability since retiree health benefits are funded by ACERA and ACERA also provides revenue to the County to offset the implied subsidy.

1 Alameda County Auditor, *Alameda County Comprehensive Annual Financial Report, 2006* (Alameda, CA: Auditor, 2006), pg. vi <http://www.acgov.org/auditor/financial/index.htm>

2 Alameda County Employees' Retirement Association, *ACERA Comprehensive Annual Financial Report, 2006* (Alameda, CA: ACERA, 2006), pg. 16 <http://www.acera.org/downloads/publications/2006CAFFRfinal.pdf>

3 ACERA, *Comprehensive Annual Financial Report*, pg. 29

4 The Active Death Equity Benefit (ADEB) is a continuance benefit paid to a qualified spouse, domestic partner or minor child upon the death of a vested active member.

5 ACERA, *Comprehensive Annual Financial Report*, pg. 33

Case Study Profile: El Dorado County

Type of Agency:	County
Number of Employees:	2,040 Active Employees; 336 Retired Employees
Revenue:	\$288,375,000 (2006/07)
Total Payroll:	\$91,500,000 (2006/07)
Participates in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Minimum age of 50 with 12 years of service

Background

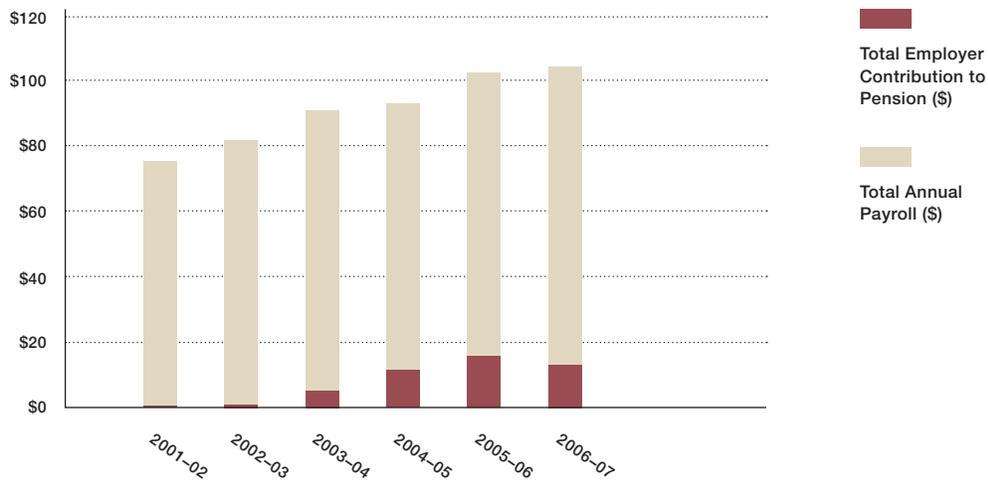
El Dorado County was established in 1850 as one of the original 27 counties making up the new state of California. The County currently has a population of nearly 173,000. El Dorado County is governed by general law with a board of supervisors/officer form of government. Under this type of government, the board of supervisors is the policy-making body, appointing the Chief Administrative Officer who is responsible for carrying out board policy. General Fund revenue is collected from diverse sources such as property tax, sales tax, license/permit fees, gas tax, cigarette tax, alcoholic beverage tax, and assessment districts and franchise fees. The Lake Tahoe area and local ski resorts are excellent sources of revenue for

El Dorado County. El Dorado County has a largely agricultural economic base during the majority of the year. The Sierra Nevada range is also in El Dorado County, where logging industries provide additional economic stimulus.

Pensions

El Dorado County is a participant in the California Public Employees' Retirement System (CalPERS), a multi-agency retirement system. The current benefit formula is "2% at 55" for all miscellaneous (general) employees and has been in place for approximately 20 years.

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



The current “3% at 50” benefit formula for safety employees went into effect in 2003. From 2001 to 2003, the benefit formula for safety employees was “3% at 55.” Prior to 2001, the benefit formula for safety employees was “2% at 55.” Safety employee benefit formulas were enhanced through bargaining negotiations in fiscal year 2000/01 and implemented in steps to bring benefits to the current level as part of a seven-year contract.

El Dorado County does not participate in Social Security.

Chart 1 compares El Dorado’s pension costs to the total annual payroll. Pension costs have ranged from .64% (2001/02) to 18.33% (2005/06) of the county’s total payroll.

As demonstrated in *Chart 2*, historical employer pension costs to the County have ranged from 0.35% (2001/02) to 7.71 % (2005/06) of the County’s total operating budget.

Retiree Health Care

El Dorado provides a County-sponsored health plan for its active and retired employees. Benefits available to active employees include health care, dental, vision, death/disability, and voluntary life insurance. Active employees pay 20% of the health care premium and the County pays 80% of the premium, regardless of which health plan an employee selects. Retirees have access to health care, dental, and

vision benefits. The County of El Dorado provides a blended risk pool for health care benefits, with a single health plan rate for active employees and retirees not yet eligible for Medicare, which helps to subsidize the amount paid by retirees for their health care premiums.

Retired employees are eligible to receive health care benefits based on the following criteria: 12 years of service immediately preceding retirement, attaining a minimum age of 50, and enrollment in an employer-sponsored health care plan at the time of retirement. The County pays for a portion of monthly retiree health plan premiums based on years of service as follows:

- **Retired employees between ages 50–65 receive:**
\$213 for 12 years of service,
\$319 for 15 years of service, or
\$425 for 20 years of service.
- **Retirees age 65 or older receive:**
\$165 for 12 years of service,
\$247 for 15 years of service, or
\$329 for 20 years of service.

Retiree health plan premiums, including dental coverage, range from \$431 to \$627 per month depending on which plan is selected. Retiree health plan premiums, excluding dental coverage, range from \$387 to \$585 per month for individual coverage.

Both eligibility requirements and the County’s contributions for retiree health care are established through bargaining agreements. The County’s OPEB contribution is capped at 1.2% of payroll, and all retiree health care contributions are funded by current budget expenditures. A 2007 actuarial report completed for El Dorado County projects that the 1.2% payroll cap will be reached in fiscal year 2010/11. If the County contribution reaches the 1.2% cap, the County will explore several options including an increase in retirees’ out-pocket-expense for health plan premiums.

As shown in *Chart 3*, total premiums for retiree health care have risen dramatically over the last several years. Costs have increased by approximately 300% over the past 7 years.

In 2001, the County conducted an actuarial valuation which identified a \$41 million unfunded OPEB liability. In 2002, El Dorado County began to set aside money to prefund its retiree health costs rather than continue on a strictly “pay-as-you-go” approach. The County set up a separate special revenue account, the County Retiree Health Care Fund, which is included in the county investment pool. The money is invested along with other county funds by the Treasurer and had a 5.27% rate of return in the 2nd quarter of 2007. The County uses a 20-year amortization period for calculating its

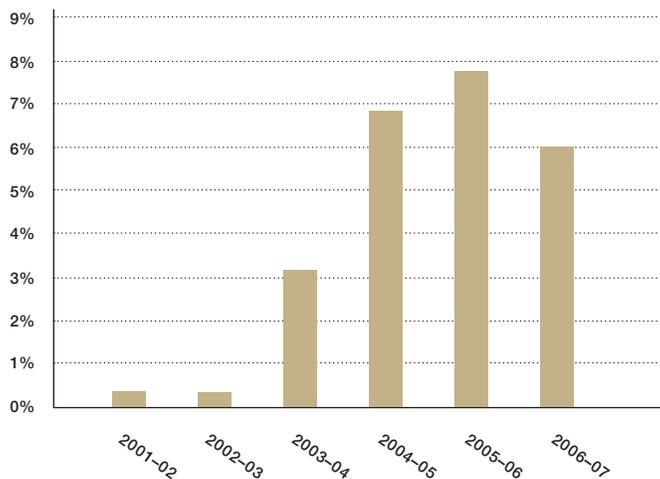


CHART 2:
Employer Pension Contribution as
a Percentage of Operating Budget

annual required contribution (ARC), instead of the standard 30 year amortization, to pay down its OPEB liabilities more quickly.

An actuarial report completed in 2007 identified an unfunded liability of \$44.5 million and an ARC of \$5.5 million using a 5.5% discount rate. The County has made significant contributions to the special reserve account in an effort to prefund liabilities as shown in *Table 1*. Although the County has made some withdrawals from the account to pay for retiree health care expenses, it continues to make

contributions above the annual budgeted retiree health care costs in order to reduce future liabilities.

El Dorado County plans to set up an irrevocable trust in the future and is currently reviewing several options for a third-party administrator to manage the trust. The County believes that a third-party manager would increase the ease of fund administration and achieve a higher rate of return. As one of the options, the County will consider CalPERS' California Employers' Retiree Benefits Trust Fund.

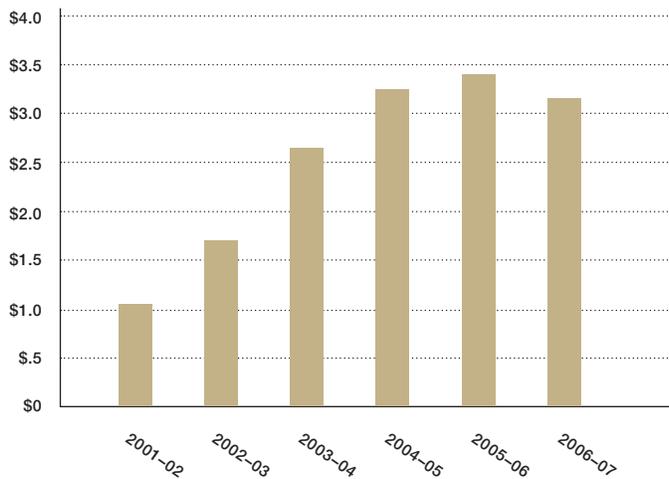


CHART 3:
Premiums Paid for Retiree Health Care
(In millions)

TABLE 1:
El Dorado County Prefunding Retiree Health Fund

FISCAL YEAR	COUNTY GENERAL FUND (GF) APPROPRIATIONS	BUDGETED RETIREE HEALTH EXPENSES	FUND BALANCE	% CHANGE IN GF APPROPRIATIONS
2001-02	\$200,000	–	\$200,000	–
2002-03	\$200,000	–	\$400,000	0%
2003-04	\$2,176,927	\$400,000	\$2,176,927	91%
2004-05	\$2,567,248	\$837,290	\$3,906,885	15%
2005-06	\$3,090,029	\$1,102,557	\$5,894,357	17%
2006-07	\$3,600,000	\$1,100,000	\$8,394,357	14%
2007-08	\$5,490,000	\$1,400,000	\$12,484,357	34%

Case Study Profile: Los Angeles County

Type of Agency:	County
Number of Employees:	92,000 Active Employees; 51,000 Retired Employees
Revenue:	\$21,044,000,000 (2006/07)
Total Payroll:	\$5,205,804,000 (2005/06)
Participates in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Retirees and survivors receiving a monthly pension benefit are eligible to participate in the Retiree Health Care plan.

Background

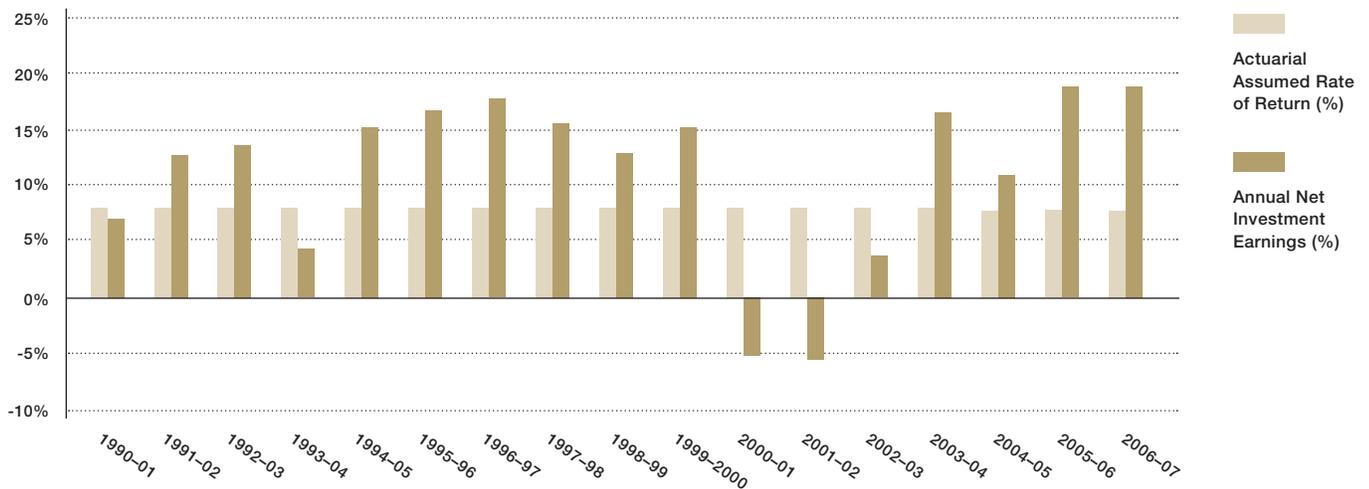
Los Angeles County is one of the original twenty-seven California counties and was formed in 1850. It is also one of the nation's largest counties with 4,084 square miles, an area about 800 square miles larger than the states of Delaware and Rhode Island combined. It has a population of more than 10 million--more residents than any other county in the nation and exceeded by only eight states. Within its boundaries are 88 cities. The City of Los Angeles is the County's administrative seat. In 1912, voters approved the charter county form of government, which took effect on June 2, 1913, with a five-member board of supervisors. Supervisors are elected by district during elections held every two

years to serve four-year alternating terms. The board functions as both the executive and legislative body of County government. The major sources of the County's revenue are property tax (20%); federal and state assistance (46%); and vehicle license fees, sales and use taxes, fines, and charges for services (34%).

Pensions

Los Angeles County has its own retirement system, the Los Angeles County Employees' Retirement Association (LACERA) operating under the County Employees Retirement Law of 1937 ('37 Act). LACERA was established in 1938 to provide

CHART 1:
Actuarial Assumed Return vs. Actual Investment Return



retirement allowances and other benefits to the safety and general members employed by Los Angeles County. Subsequently, LACERA expanded to include four other agencies: Little Lake Cemetery District, Local Agency Formation Commission, Los Angeles County Office of Education, and South Coast Air Quality Management District. LACERA has 149,000 members (active, deferred, and retired).

LACERA has seven defined benefit pension plans: five for general/miscellaneous employees and two for safety employees. Only three of those plans are available to new hires. New general members have the option to choose a non-contributory plan (Plan E) or a contributory plan (Plan D).

Unlike many other public agencies in California, Los Angeles County has not increased its pension formulas in the last decade for general or safety employees. When many other counties adopted higher benefit formulas, Los Angeles County did not follow suit due to concerns over cost and the resulting increase to its future pension liability.

General Members

Plan D--Employees are eligible to receive a retirement allowance at age 50 with ten years of service credit; at any age with 30 years of service credit; and at age 70, regardless of years of service credit. Plan D provides pension benefits ranging from 1.2% of pay

per year of service at age 50, to 2.4% at age 65. Plan D members tend to retire at age 62 at 2.1% and at age 65.

Plan E--Employees are eligible to receive a retirement allowance at age 55 with ten years of service credit or at age 70 regardless of service credit. This non-contributory plan provides a retirement benefit that ranges from 0.75% of pay per year of service at age 55 to 2% at age 65. Similar to the general contributory plan, Plan E members tend to retire at age 62 at 1.5% and at age 65.

Safety Members

Los Angeles County offers the “2% at 50” pension formula to all of its safety members.

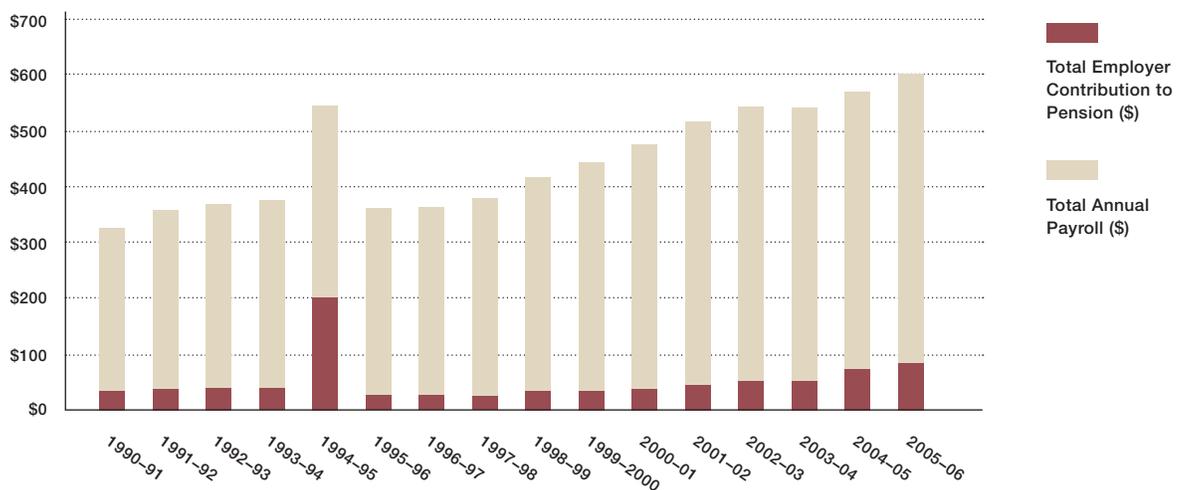
As of June 30, 2007, LACERA’s net assets totaled \$40.9 billion, with an increase of 16.3% from the previous year. The latest actuarial valuation, as of June 30, 2006, determined LACERA to have a funding ratio of 90.5% and an unfunded actuarial accrued liability (UAAL) of \$3.4 billion. The 19.1% (18.8% net) investment return generated in fiscal year 2006/07 significantly exceeded the actuarial assumed earnings rate of 7.75%. Investment returns make up approximately 80% of the annual additions to the fund.

The County’s contribution rate for 2007/08 equals 3.49% of payroll for the amortization of the UAAL over a rolling 30-year period plus the normal cost of 9.42%, for a total contribution rate of 12.91% of payroll.

To make its contributions to LACERA, the County makes monthly cash payments and/or directs LACERA to transfer funds from its County Contribution Credit Reserve (CCCR). Employer contributions shown in *Chart 3* reflect only cash payments received from the County. (The spike in 1994/1995 is attributable to the plan sponsor issuing a \$2.1 billion pension obligation bond.) In 2007, the County directly paid approximately 10.5 months of contributions; in 2006 and 2005, the County directly paid approximately 9.5 months and 8.5 months of contributions, respectively. The balance of the employer contributions were paid through transfers from funds available in the CCCR.

The CCCR was created pursuant to the 1994 Retirement System Funding Agreement between LACERA and the County. Seventy-five percent (75%) of excess earnings in fiscal years 1994/95 through 1998/99 were deposited into the reserve. Deductions include payments, as the County

CHART 2:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



authorizes, for current and future employer contributions due LACERA and for funding the Retiree Healthcare Account. The Retiree Healthcare Account is used to subsidize a portion of the Retiree Healthcare Program under the provisions of Internal Revenue Code Section 401(h).

survivors, and their eligible dependents. LACERA also administers a long-term care program for close to 4,200 participants. The County-sponsored HBP offers county retirees an extensive choice of medical plans, as well as two dental/vision plans. The participant's cost for insurance varies according to the years of service credit with LACERA. The participant also must pay any additional premiums, based on the plan selected and the number of people covered, not covered by the employer contribution. The County's employer contribution ranges from 40% of the cost for the "benchmark" health plan for a retiree with 10 years of service, up to 100% of the cost for the

Retiree Health Care

Under an agreement with the County of Los Angeles, LACERA administers a Health Care Benefits Program (HBP) that provides medical, dental, and vision benefits for approximately 39,000 retirees,

CHART 3:
Employer Contribution as a Percentage of Annual Payroll

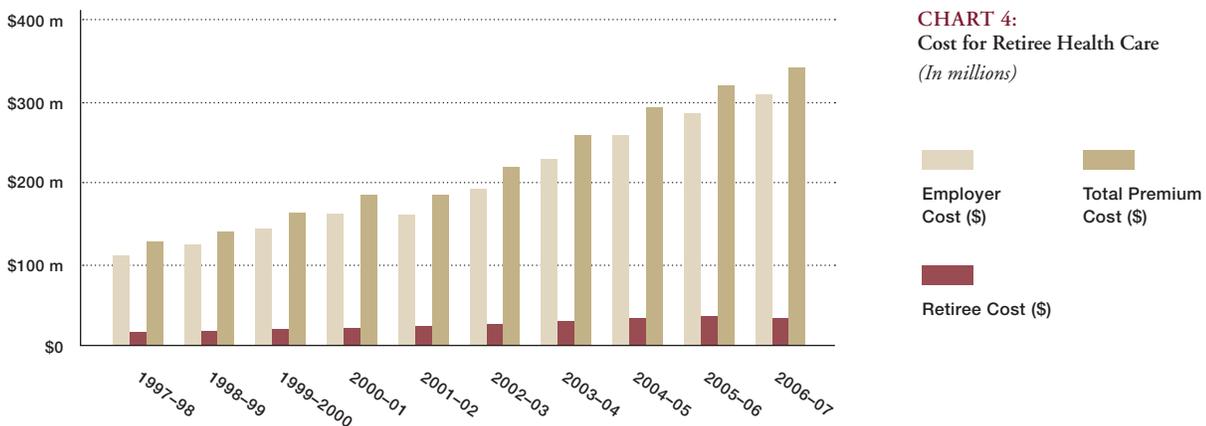
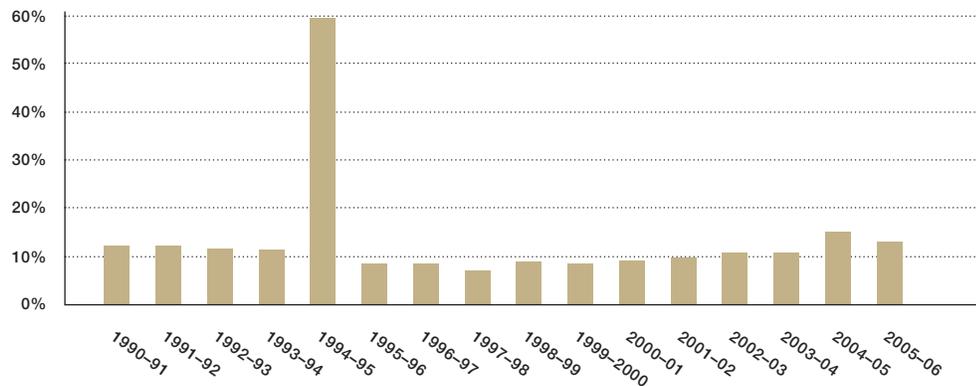


CHART 4:
Cost for Retiree Health Care
(In millions)



“benchmark” health plan for a retiree with 25 years of service. The benchmark plan is an indemnity plan covering 80% of eligible health care expenses.

The HBP is designed to provide quality care utilizing cost-effective practices. All retiree health plans offer disease management programs. In addition, the HBP reimburses the standard Medicare Part B premium for retirees enrolled in a Medicare Risk HMO or Medicare Supplement Plan. And all plan participants are encouraged to attend periodic HBP Wellness Program seminars.

Beginning in fiscal year 1997/98, the County and LACERA entered into an agreement establishing a health care funding account pursuant to Section 401(h) of the Internal Revenue Code. Section 401(h) permits the establishment of a separate account (a “401(h) account”) in the pension system to fund retiree health care benefits, and limits contributions to the 401(h) account to 25% of aggregate contributions to LACERA since the 401(h) account was established. Funding the HBP through a 401(h) account allows the County to use a portion of excess

earnings from the County Contribution Credit Reserve (CCCR) to replace employer contributions paid from the 401(h) account. During fiscal year 2006/07, total health plan premiums were \$338 million. This cost was funded by \$32.8 million of retiree contributions, as well as employer contributions totaling \$305 million, of which \$29.4 million was paid through the 401(h) account.

The County and the unions are continuing to discuss the escalating cost of health care for active and retired employees and possible solutions to mitigate the cost, such as prefunding OPEB liabilities. In October 2007, the County approved establishing an employer-controlled IRS Section 115 trust fund, or a trust as an integral part of the County under the doctrine of intergovernmental tax immunity, to facilitate prefunding of OPEB liabilities. The trust documents are being prepared and will be subject to labor “meet and confer” requirements. It is expected that LACERA will be responsible for investing trust assets. At this time, no assets have been specifically identified for the prefunding of OPEB liabilities.

Case Study Profile: Orange County

Type of Agency:	County
Number of Employees:	16,868 Active Employees; 8,914 Retired Employees
Revenue:	\$5,560,311,552 (2006/07)
Total Payroll:	\$1,366,200,000 (2006/07)
Social Security Participation?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Retiree Health Care Eligibility:	At least 10 years of service and a minimum age of 50.

Background

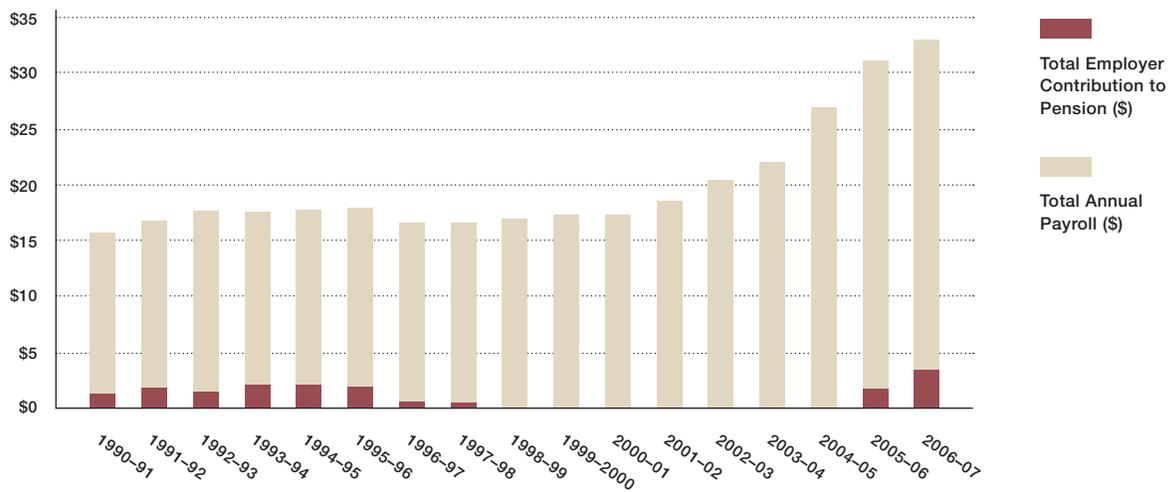
Orange County was established in 1889. The County occupies 798 square miles with a coastline of 42 miles and a population of approximately 3 million. It is the second most populous county in the state. Orange County is governed by general law with a board of supervisors/officer form of government. Under this type of government, the board of supervisors is the policy-making body, appointing the chief administrative officer who is responsible for carrying out board policy. General Fund revenue is collected from diverse sources such as property tax, sales tax, license/permit fees, gas tax, cigarette tax, alcoholic beverage tax, assessment districts, and franchise fees.

Pensions

Orange County operates its own retirement system under the County Employees' Retirement Law of 1937 (the 37 Act). The Orange County Employees' Retirement System (OCERS) is a cost-sharing multi-employer public employee retirement system established by the voters of Orange County in 1945. OCERS is a defined benefit retirement plan for employees of the County, as well as employees of participating cities and special districts within the County.

The current benefit formula for all general (miscellaneous) County employees is "2.7% at 55." This benefit formula was adopted on August 24,

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



2004, and became effective July 1, 2005. General employees were previously separated into two tiers for retirement benefit formulas: Tier I provided a benefit based on the “2% at 57” formula, while Tier II provided a benefit based on a “1.667% at 57.38” formula.

The current benefit formula for safety employees is “3% at 50.” This benefit formula was adopted on December 4, 2001, and became effective June 28, 2002. The previous benefit formula for safety employees was “2% at 50.”

To be eligible for a retirement benefit, all employees must retire with 10 years of qualifying service and the minimum age of 50; retirement at any age with 30 years of qualifying service (20 years for safety); or retirement at age 70, regardless of service credit.

Orange County does not participate in Social Security.

Chart 1 compares Orange County’s employer pension contributions with annual payroll. During the seven year period from fiscal year 1998/99 through 2004/05, the County benefited from a “contribution holiday”, meaning that no employer contributions were paid to the pension system during that time.

As demonstrated in *Chart 2*, historical pension costs to the County, as represented by total employer contributions, have ranged from 0.00% to 3.86% of the County's total operating budget.

Chart 3 compares actual investment returns of OCERS to the actuarially assumed rates of return. Although in some years the investment returns were significantly lower than assumed, OCERS has achieved a greater rate of return than assumed in 11 out of the 17 years represented.

Health Care

Active Employees

Orange County's active employees have access to health care, dental, vision, death/disability, and life insurance. For general employees, the County pays for 95% of the health care premium for the employee only and 75% of the premium for one dependent. For safety employees, the County pays a flat rate of \$620 per month for the employee and \$315 per month for one dependent.

CHART 2:
Employer Contribution as a Percentage of Operating Budget

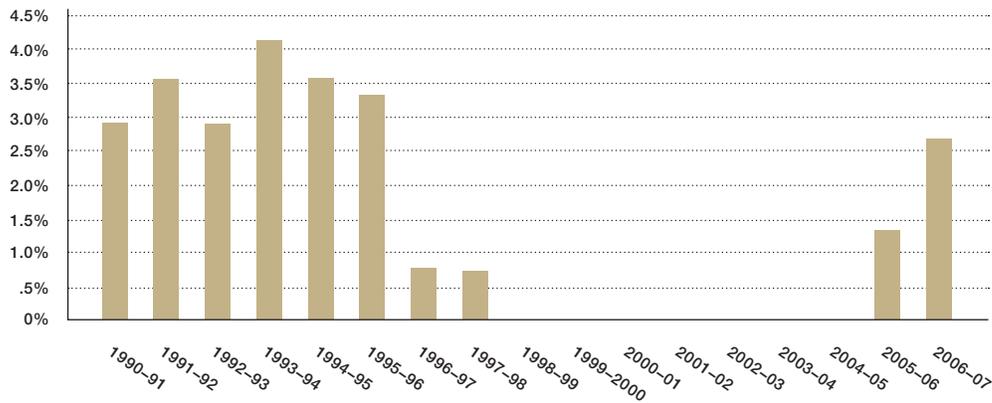
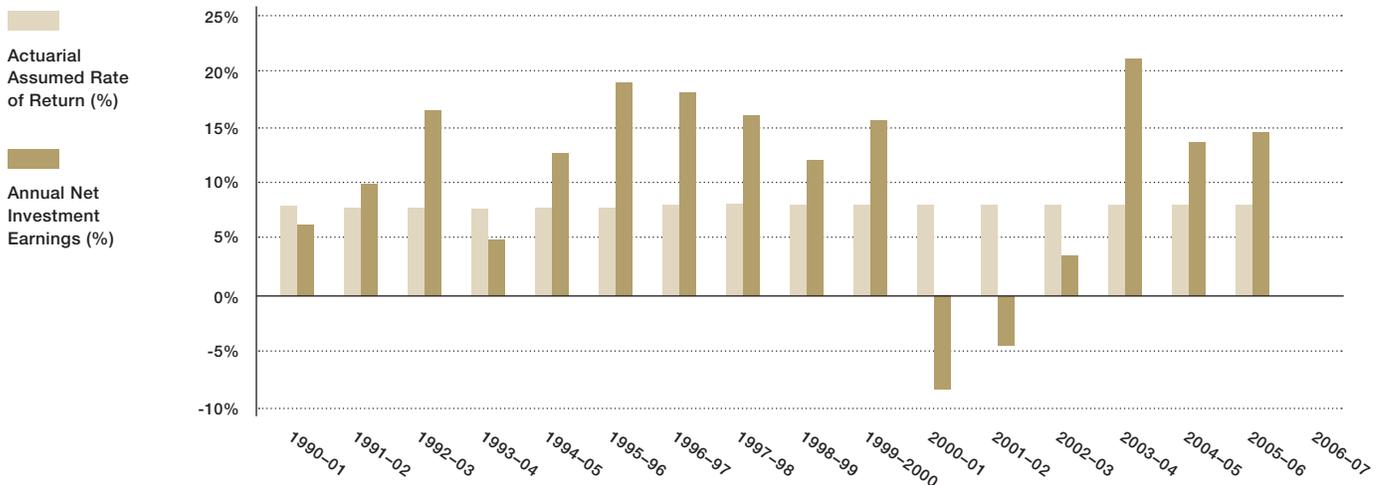


CHART 3:
Actuarial Assumed Return vs. Actual Investment Return



Retired Employees

The Orange County Board of Supervisors does not consider retiree health benefits to be vested. It reserves the right to change those benefits and has recently done so.

Retirees have access to health and dental benefits. Retirees who have at least 10 years of continuous service with the County and have reached the minimum age of 50 qualify for a monthly employer contribution from the County. As discussed below, the size of the contribution has varied over the past two decades.

Historically, retirees have participated in the same health plans (and risk pool) as active employees. However, in September 2006, the Board of Supervisors made the decision to place retirees in separate health plans due to the increased health plan cost for active members. This action also has the result of eliminating the County's implied subsidy liability under GASB. This change will take effect January 1, 2008 and is expected to significantly increase retirees' premiums or even prevent some from being able to find affordable health care coverage on the individual market.

Funding

The most recent actuarial report, using data as of 2006, identified an unfunded liability of \$1.4 billion and an annual required contribution (ARC) payment of \$130 million (with a discount rate of 7%). Over the past 15 years, there have been three different funding approaches used by the County to pay for retiree health benefits.

Between 1992 and 2003, there was an Additional Retirement Benefit Account (ARBA) maintained by OCERS. The County recognized an obligation to provide for retiree health benefits and believed the ARBA mechanism was the best mechanism available at the time. Retirement system earnings in excess of those necessary to fund reserves were available to be transferred into the ARBA to pay for health premiums, as long as at least 1% of plan assets were held back in the Unallocated Fund Balance, as required by the '37 Act. By 1992, OCERS had accumulated an excess 13% above the level necessary to fund all reserves. A portion of this excess was transferred into the ARBA in 1992, followed by other

periodic transfers. The amount of those transfers are as follows:

- In 1992: the first allocation of \$19,168,931;
- In 1992, an additional \$26,991,838;
- In 1993, \$20,157,794;
- In 1996, \$11,183,883;
- In 1997, \$57,476,830;
- In 1999, \$16,358,360; and
- In 2000, \$200,870,015.

In 2002, after the fall in the stock market, the County came to believe that there was not going to be sufficient excess earnings to continue funding the ARBA. New agreements were entered into between the County and OCERS (employee groups were not included) creating the Retired Member Benefit Reserve (RMBR), which required a cash contribution from the County to establish a three-year reserve for the employer contribution. The amount of the employer contribution remained the same, as did the eligibility requirements. Under the new arrangement, the County directly paid the employer contribution, rather than funding from OCERS' excess earnings. The funds for the RMBR account initially came in part from a mandatory monthly deduction from all active employees of 1% of pay, although that deduction has been discontinued.

In 2003, the first year of Orange County's RMBR funding approach, a County contribution of \$22.5 million was required. In 2004, OCERS received \$1,527,016 from the County, and in 2005 it received \$2,073,557. The RMBR agreement was due to sunset on December 31, 2007, but the County terminated it early and replaced it with a 401(h) trust, which was approved in July 2007. The employer contribution paid out of this new trust is called the Retiree Medical Insurance Grant (RMIG). The County favored this approach because it allows health care funds to be invested alongside pension assets to earn higher rates of return.

In 2007, the initial transfer into the 401(h) account was \$59.5 million, which met the entire County liability for the year. In addition to the 401(h) account, the County has a 115 integral trust managed by the County Treasurer. Money from the 401(h)

account pays for the monthly employer contribution toward retiree health benefits, while the funds from the 115 trust are used to pay for lump-sum payments to employees who are not eligible to receive the employer contribution for health care (Upon separation from employment, those employees with less than 10 years of service credit, or who are not old enough to retire, receive a lump sum payment based on the amount of their contributions towards health care and years of service.)

The role of OCERS in this new arrangement is to invest and manage the 401(h) account funds, then pay benefits as directed by the County, which is responsible for administering the retiree health care program. The new Retiree Medical Insurance Grant provides an employer contribution based on \$10 per month for each full year of service, up to a maximum of \$250 per month. Each fiscal year, the amount of the grant will be adjusted by the average percentage increase in the County's health plan premiums, not to exceed 5% per year. However, the Retiree Medical Insurance Grant can never exceed the actual cost of the health insurance or Medicare premiums. While the County still cites the \$250 amount listed above, it has already adjusted the contribution arrangement by cutting the monthly grant to retirees in half (please see letter).

Summary

Unlike many of the other agencies profiled in this report, Orange County has addressed OPEB liabilities by choosing to drastically change the structure of its retiree health plan to lower costs rather than to fund previous obligations.

The County has taken two significant actions in the past year to lower its OPEB costs:

First, the County once pooled both active and retired employees in the same health care cost pool. This served to provide retirees access to coverage at a subsidized group rate. However, the County has recently decided to "de-pool" active employees and retirees, which will lower the active employee premium somewhat while greatly increasing the premium for retirees. Because the employer contribution for active employees is based on a percentage of health plan premiums, this action will decrease employer contributions for active employees in the short term, as well as eliminate its GASB 45 implied subsidy liability. The consequences for retirees, however, are likely to be both negative and significant.

Second, for at least the last 15 years, the County provided its retirees with an employer contribution of up to \$250 per month, depending upon length of service. However, on September 1, 2007, the County sent all retirees a letter (see next page), informing them that the monthly contribution will be cut in half, effective October 1, 2007. The County justified this reduction by suggesting that Medicare supplemental coverage is less costly, so the retirees would - presumably - need less money. It should be noted that Orange County does not participate in Social Security, and its employees did not participate in Medicare until 1986. This should provide Medicare eligibility to all those County employees who have retired since approximately 1995, but does nothing for the oldest retirees who retired without the necessary 40 quarters of Social Security/Medicare coverage.



County of Orange

Public Employee
Post-Employment
Benefits Commission

Section I:
Orange County

September, 2007

To: County of Orange Retirees
From: Human Resources, Employee Benefits

**Subject: Restructuring of the Retiree Medical Program Retirees
Under the Age of 65**

As you may recall, in November 2006 you received correspondence regarding a number of changes being made to the Retiree Medical Program in order to preserve the program. These changes have allowed the County to stabilize the annual costs of the program; thereby, allowing the County to retain a restructured program for our retirees. This correspondence is to serve as clarification and/or confirmation regarding the changes as they impact your grant with the County of Orange.

Due to the restructuring of the Retiree Medical Program, Retirees who are eligible for both Medicare Parts A and B will have a 50% reduction in their monthly Retiree Medical Grant as of October 1, 2007. Please be advised that you will experience a 50% reduction in your monthly Retiree Medical Grant effective October 1, 2007. Additionally, there will be a reduction in your health plan premiums when you enroll in both Medicare Parts A and B because Medicare is primary and your County health plan is secondary. Your Grant (which is based on the number of your County Service Hours) will be applied first to offset the cost of your County retiree health plan premiums, and any remaining monthly grant will be applied to the Medicare Part B reimbursement. If the total of your monthly health plan premium, plus your monthly Medicare Part B reimbursement is less than the total monthly grant, the excess grant will remain in the program.

While we understand the changes which are taking place may be a source of concern and confusion, we want to assure you that the County of Orange values our retired County Family members, and we share your desire to maintain affordable, high-quality benefit programs for our retirees. The County of Orange remains committed to providing quality, affordable benefit programs, and educating employees and retirees in making wise health care decisions.

Should you have any questions regarding your grant, how your grant is calculated, enrollment and/or eligibility you may contact the Benefits Resource Line toll-free at 1-866-325-2345 for assistance.

Case Study Profile: San Diego County

Type of Agency:	County
Number Employees Total:	17,451 Active Employees; 12,049 Retirees
Revenue:	\$3,553,330,000 (2005/06)
Total Payroll:	\$921,796,000 (2005/06)
Participates in Social Security?	Only for miscellaneous (general) employees
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Limited to retirees in Tier I and Tier II; however, all retirees have access to a SDCERA sponsored health plan at full cost to the retiree.

Background

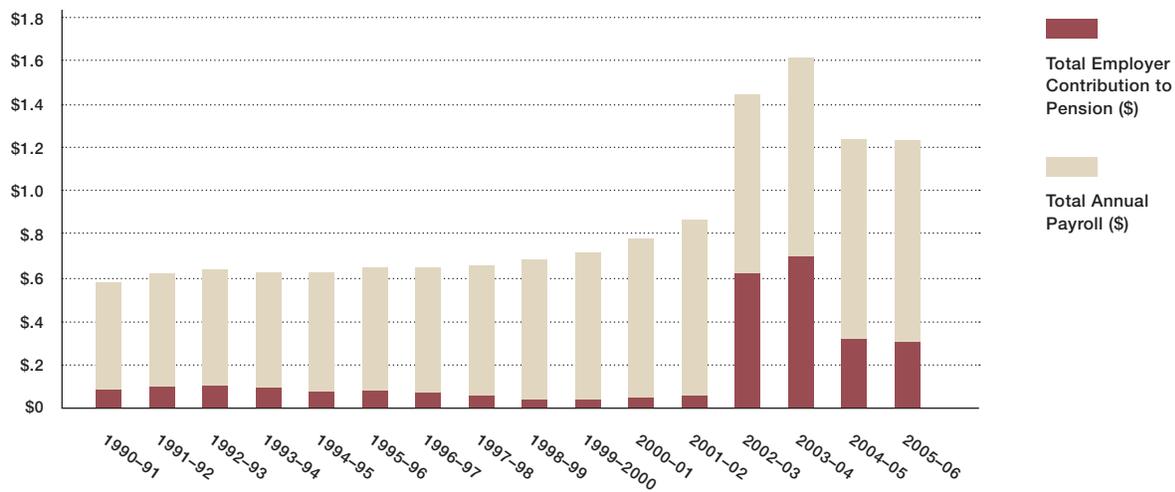
The County of San Diego was incorporated on February 18, 1850 as one of the original California counties, and functions under a charter adopted in 1933. The County's population in January 2006 was reported to be 3,066,820, and it is the third largest county by population in California behind Los Angeles and Orange Counties. The County is governed by a five-member Board of Supervisors elected to four-year terms in district nonpartisan elections. The City of San Diego is the largest city in the County, with a population of approximately 1.3 million. The County's economic base includes manufacturing of electronics and shipbuilding, the

tourist industry, and defense-related industries. The main sources of County revenue are property and sales taxes (51 percent) and federal and state funded programs (31 percent).

Pensions

The San Diego County Employees' Retirement Association, SDCERA, is an independent retirement system governed by the statutes of the '37 Act. The San Diego County Board of Supervisors is the plan sponsor, while SDCERA is administered by the nine-member Board of Retirement. SDCERA provides

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In billions*)



retirement and associated benefits for eligible employees of the County of San Diego and other participating employers.

On June 30, 2006, the actuarial value of assets was \$6.3 billion, and the actuarial accrued liability was \$7.5 billion, resulting in an unfunded actuarial accrued liability of \$1.2 billion. For the fiscal year ending June 30, 2006, the plan's funding ratio was 83.6%. Employer and employee contributions totaled \$344 million, representing a combined contribution rate of 23.1% of payroll. Investment earnings, net of benefits and administrative expenses, totaled \$628 million.

As presented in *Chart 2*, pension costs for the County have ranged from 5.62% to 75% of annual payroll. The high contribution rates that occurred during the period of 2002 through 2004 is disproportionately impacted by the deposit of revenues generated by three separate pension obligation bond (POB) issues. In February 1994, the County of San Diego issued a POB in the amount of \$430.4 million and transferred \$428.5 million of that issuance to the retirement fund. Those funds were deposited with SJCERA in February 1994. The combined contribution rate of 12.71% for that fiscal year was in addition to the POB funds. In 2002, a POB

was issued that totaled \$737 million, of which the County transferred \$550 million to the retirement fund. The remaining amount was used by the County to retire a portion of the POB still outstanding from 1994. In June 2004, the County again issued pension obligation bonds in the amount of \$454.1 million with \$450 million transferred to the retirement fund for meeting the County’s unfunded obligations.

Miscellaneous (general) and safety employees who entered the retirement system prior to October 1, 1978 are designated as Tier I members. Tier I is closed to new entrants. The County Board of Supervisors established a second tier (Tier II) of retirement benefits for employees entering the retirement system on or after October 1, 1978. For general members, Tier I provided a “2% at 57” formula and Tier II provided a “2.3% at 60” formula. Safety members earned a retirement allowance based on the “2% at 50” benefit formula.

On March 8, 2002, the County Board of Supervisors eliminated Tier II. A new “Tier A” was established, which offered a “3% at 60” benefit formula for general members and a “3% at 50” benefit formula for safety members. Active members of Tier I and Tier II were placed into these new formulas. Tier II general members were given a one-time opportunity to opt out of the new Tier A plan. When Tier II was eliminated, all deferred or inactive general members with Tier II service credit and active members who elected to opt out of Tier A were converted to Tier I

(except deferred safety members who were converted to the “3% at 50” formula provided in Tier A). The benefit formula enhancements provided in March 2002 through the new Tier A plan have significantly impacted pension liabilities. Within four months of the higher benefit formulas being provided, more than 800 employees retired. The pension surplus of \$238 million prior to the March 2002 enhancements became a \$1.2 billion pension liability.

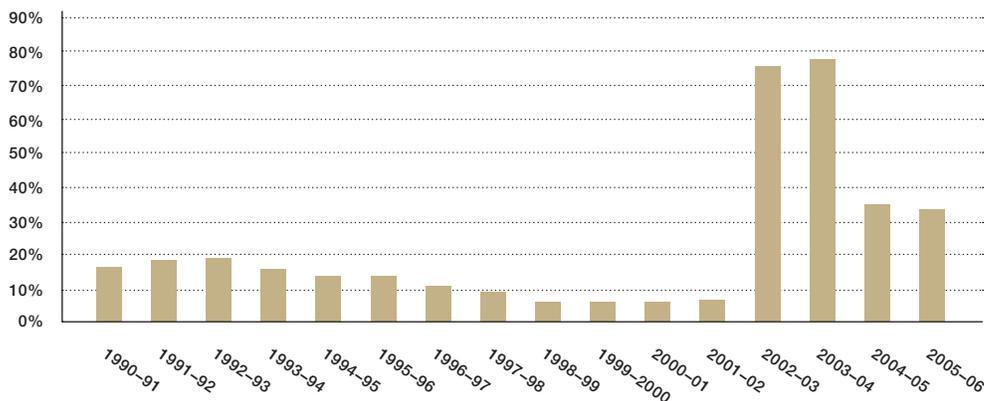
Under the ‘37 Act, pensions are vested when an employee completes five years of service credit, but cannot be received before achieving at least ten years of membership in the retirement system and a minimum age of 50. Time as an inactive member of the system contributes toward the ten year membership requirement. In addition, a member may retire regardless of age once obtaining 30 years of credited service for general members and 20 years of credited service for safety employees.

Retiree Health Care

According to an actuarial valuation performed for the County, the annual required contribution (ARC) for OPEB benefits for fiscal year 2007/08 is \$23.6 million, and the County has a total OPEB liability of \$235 million. Health care benefits are not considered vested in San Diego County.

In 2000, the County’s Board of Supervisors and the SDCERA Board of Retirement adopted a funding

CHART 2:
Employer Pension Contributions as a Percentage of Annual Payroll



mechanism under Section 401(h) of the Internal Revenue Code, which calls for a portion of the County's contributions to be set aside in a separate account each year called the "401(h) Account". The 401(h) Account is used exclusively to fund retiree health benefit subsidies. The system's excess earnings have been used to offset the County's contribution to the 401(h) account. Assets in the 401(h) Account are commingled with pension fund assets for investment purposes, and as of June 30, 2006, the 401(h) Account had \$10 million in total assets.

Retirees with at least ten years of credited service under Tiers I and II (generally those who retired prior to March 2002) currently receive a health allowance funded by the County and paid from the 401(h) Account. The amount of the health allowance varies according to total service credit. Those who retired from Tier I or II receive a health allowance of up to \$400 per month for an employee with 20 years of credited service. Those who are eligible for Medicare receive up to a maximum allowance of \$300 per month, plus \$93.50 reimbursement for Medicare Part B premiums.

Tier A retirees (generally those hired after March 2002) are no longer eligible for the "health allowance." Tier A retirees will be eligible for a "pension supplement" which can be used at their own discretion, whether for health benefits or otherwise. When the Board of Retirement established this

pension supplement in May 2007, it stated that the benefit funding would be maintained for five-years. The future funding for this pension supplement is contingent upon a new "excess earnings" policy, which became effective on July 1, 2007. The new policy clarifies the Board of Retirement's discretion concerning the use of excess earnings in relation to the plan's funding ratio. If the plan's funding ratio is below 90%, excess earnings would be used to fund the pension liability. If the funded ratio is between 90% and 100%, then 75% of the excess earnings will be used to fund the pension liability and 25% will be available to be used at the Retirement Board's discretion. If the plan's funded ratio is between 100% and 115%, then 50% of the excess earnings will be used to fund the pension liability and 50% will be available to be used at the Board's discretion. If the funding ratio exceeds 115%, the Board will have total discretion on the use of excess earnings. It is assumed that at least a portion of the excess earnings under the Board's discretion would be used to continue funding the pension supplement.

SDCERA was informed by its health insurance carriers that retiree group insurance policies may no longer be offered if the sponsor (either SDCERA or the County) does not provide the retirees with at least 50% of the health care premium. Insurers are concerned that without financial participation from the plan sponsor, there will be adverse selection problems in the retiree health insurance group.

Case Study Profile: City and County of San Francisco

Type of Agency:	County/City
Number of Employees:	29,174 Active Employees; 20,185 Retired Employees
Revenues:	\$5,749,169,447 (2006/07)
Total Payroll:	\$2,362,972,537 (2006/07)
Participates in Social Security?	Miscellaneous: Yes; Fire/Police/Deputy Sheriffs: No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Five years of service

Background

The City and County of San Francisco was established by a charter on April 15, 1850. San Francisco is the fourth largest city in California, with a population estimated at 798,680 (based on 2005 data). It is the only consolidated city and county in the state, and under state law, it exercises the powers of both city and county. The mayor and the board of supervisors are elected; there is no city council. The four largest sources of San Francisco's General Fund (79% of the operating budget) revenue are derived from property tax (32%), other local taxes (18%), state government (17%), and business taxes (13%).

Changes to San Francisco's pension plan and employee and retiree health benefits require a charter amendment which necessitates a vote by the electorate.

Pensions

Employees of the City and County of San Francisco, the San Francisco Unified School District, the San Francisco Community College District, and the courts who are eligible for membership in

a pension plan are members of either the San Francisco Employees' Retirement System (SFERS), the California Public Employees' Retirement System (CalPERS), or the California State Teachers' Retirement System (CalSTRS).

- Miscellaneous, fire, and police are members of SFERS, as are court employees and classified employees of the San Francisco City Unified School District and the Community College District.
- Deputized employees of the sheriff's office, institutional police (e.g. airport police, housing authority police), district attorney investigators, and probation officers are members of CalPERS.
- Certificated employees of the San Francisco City Unified School District and the Community College District are members of CalSTRS.

The original San Francisco retirement system was created in 1889 to provide limited benefits for firefighters and job-related death benefits for general members. In 1932, SFERS, a defined benefit plan, was created by a charter amendment. It provides service retirement, disability retirement, and pre- and post-retirement death benefits.

The Retirement Board of SFERS is responsible for managing the investment of retirement systems assets; establishing policies governing the administration,

management, and operation of the retirement plans; and making determinations of disability or job-related death benefit eligibility.

There are separate plans for miscellaneous, fire, and police employees. Each plan has two tiers referred to as the "Old Plan" and the "New Plan." The Old Plans apply to individuals who were employed prior to November 1976, and the New Plans apply to those hired after November 1976.

The New Plan for miscellaneous employees requires 5 years of service credit to vest, and the pension benefit is capped at a maximum of 75% of final compensation. This benefit formula has been in effect since the New Plan was created. SFERS uses a one-year final compensation period, although prior to 2000, a three year average was used to determine final compensation. Miscellaneous employees who retire before age 60 with less than 20 years of service credit receive a prorated benefit formula beginning with "1% at 50" and increasing by 0.1% for each year of age over 50 the retiree possesses at the time of retirement.

The New Plans for fire/police employees requires 5 years of service credit to vest, and the benefit is capped at a maximum of 90% of final compensation. The fire and police plans also use a one-year final compensation period.

The plan characteristics are outlined in *Table 1* below.

The SFERS has reciprocity with CalPERS, CalSTRS, the 1937 Act county retirement systems, and other local, independent retirement systems that have a reciprocity contract with CalPERS. Miscellaneous employees are covered by Social Security, while safety employees are not.

In 2005/06, San Francisco's composite contribution rate to SFERS for fire, police, and miscellaneous members was 6.58% (SFERS changed from separate rates for fire, police and miscellaneous categories to a composite rate beginning in 2004/05). *Chart 1* demonstrates historical changes in the employer

contribution rate. As of June 30, 2006, the system is 108% funded.

Chart 2 presents the SFERS pension contributions as a portion of total payroll costs. During fiscal years 1995/96 through 2003/04, San Francisco made no employer contributions to SFERS. That contribution holiday was largely due to a reduction in the annual required contributions (ARC) resulting from high investment earnings during the late 1990s.

For fiscal year 2005/06, San Francisco's contribution to SFERS amounted to \$126,772,942. This represented approximately 2.2% of the operating budget (\$5,748,905,286).

TABLE 1:
SFERS Plan Characteristics

PLAN	EMPLOYEE CONTRIBUT. RATE	FORMULA	MAX BENEFIT	FINAL COMPENSATION	ELIGIBILITY REQUIREMENTS	ANNUAL COLA	INDUSTRIAL DISABILITY
Misc., Old	8%	2% @ age 60	75%	One year final compensation, including overtime	Age 50 with 5 years of service	Up to 2%	N/A
Misc., New	7.5%	2% @ age 60	75%	One year final compensation, excluding overtime	Age 50 with 5 years of service	Up to 2%	N/A
Fire, Old	7%	3% @ age 55	90%	Salary earnable at retirement assuming the individual has been in his/her rank at least one year	Age 50 with 25 years of service	50% of pay increases granted to the rank from which retired	50%-90%, depending on Workers Comp rating
Fire, New	7.5%	3% @ age 55	90%	One year final compensation	Age 50 with 5 years of service	Up to 2%	50%-90%, depending on Workers Comp rating
Police, Old	7%	3% @ age 55	90%	Salary earnable at retirement assuming the individual has been in his/her rank at least one year	Age 50 with 25 years of service	50% of pay increases granted to the rank from which retired	50%-90%, depending on Workers Comp rating
Police, New	7.5%	3% @ age 55	90%	One year final compensation	Age 50 with 5 years of service	Up to 2%	50%-90%, depending on Workers Comp rating

CHART 1:
History of Employer Pension Contributions

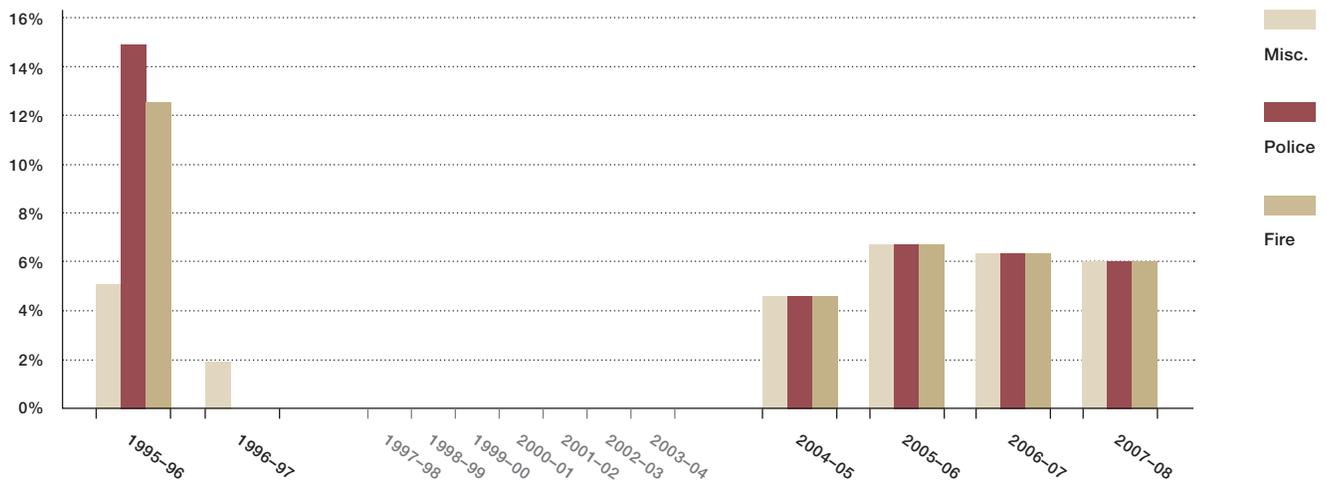
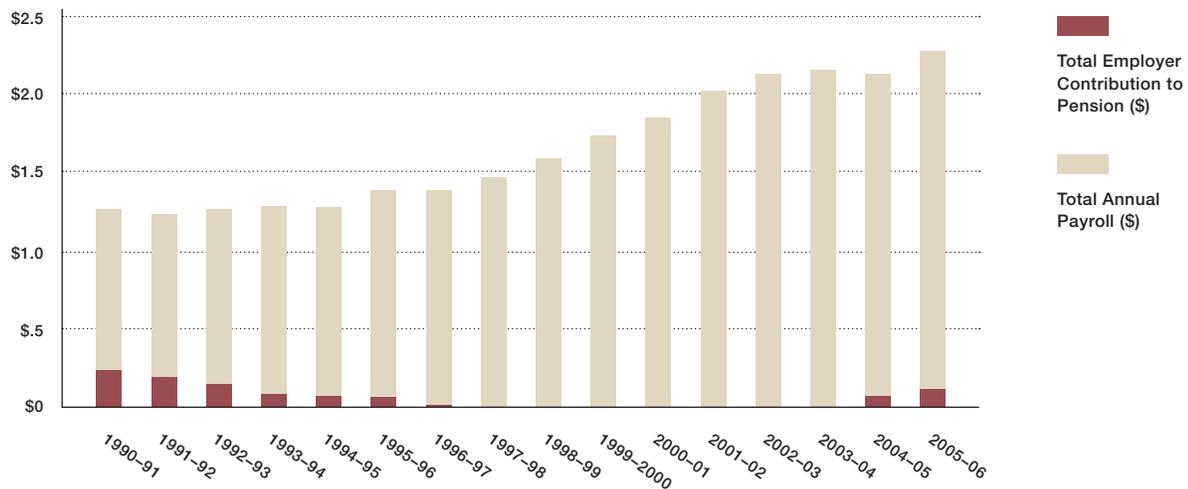


CHART 2:
Employer Pension Contribution as Proportion of Total Annual Payroll (In billions)



Retiree Health Care

Health, dental and vision benefits are provided to retirees and eligible survivors. These benefits are included within the City charter and are administered by the San Francisco Health Services System (SFHSS). These benefits are available to all retirees and eligible survivors regardless of the retirement system from which pension benefits are received. Active employees and retirees are in separate cost pools, so different health plan premium rates are charged. SFHSS offers five health care plans, four dental plans, and one vision care plan.

San Francisco contributes approximately 90 – 98% of the health care premium for the retiree only and approximately 70 – 85% of the premium for one dependent. For surviving spouses, San Francisco also picks up 90 - 98% of the premium plus 64 - 69% for one dependent. The amount of the premium paid by the employer is determined through collective bargaining and can differ by employing entity (i.e. City and County of San Francisco, San Francisco Unified School District, San Francisco Community College District, and the courts).

Health coverage is tied to retirement eligibility. Consequently, employees with five years of service

are eligible for the employer contribution towards health coverage when they retire, regardless of any elapsed period between separation from employment and the employee's retirement date. San Francisco considers retiree health benefits to be vested because they are included within the charter and any changes would require a charter amendment voted on by the electorate.

In 2006, San Francisco completed its first OPEB actuarial valuation which identified an unfunded liability of almost \$5 billion and an annual required contribution (ARC) of \$455,881,165, using a discount rate of 4.5% and an amortization period of 30 years. According to the valuation, if San Francisco prefunds OPEB costs in a manner allowing the use of an 8% discount rate, the unfunded liability would be reduced to \$3 billion, with an ARC of \$290,209,863.

San Francisco has not yet decided how to address the unfunded liability for retiree health coverage. Proposed charter amendments are being considered to reduce San Francisco's OPEB financial exposure for former employees. In 2007, San Francisco indicated its desire to prefund by setting aside \$500,000 for that purpose.

Case Study Profile: Santa Clara County

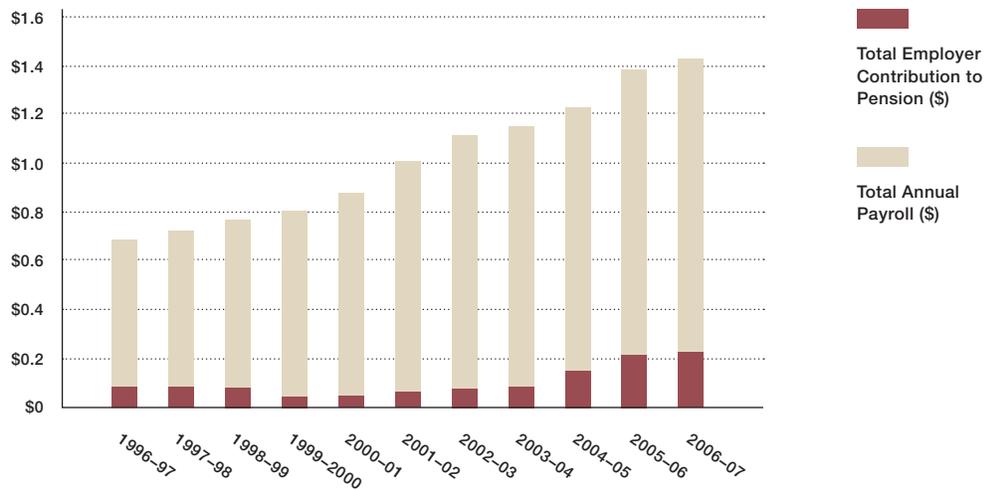
Type of Agency:	County
Number of Employees:	15,069 Active Employees; 6,712 Retired Employees
Revenues:	\$3,528,916,316 (2006/07)
Total Payroll:	\$1,211,289,012 (2006/07)
Participates in Social Security?	Only for Miscellaneous (General) Employees
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Five years of County service, if hired before 8/12/1996; Eight years, if hired after 8/11/1996; Ten years, if hired after 6/18/2006. Must retire at a minimum age of 50.

Background

Santa Clara County was one of the original counties of California, established in 1850 at the time of statehood. The County's population of nearly 1.7 million is one of the largest in the state, following Los Angeles, San Diego, and Orange Counties. It is the largest of the nine Bay Area counties. The County of Santa Clara is also referred to as "Silicon Valley" because it has been home to the nation's technology sector since 1971 and hosts the headquarters for such companies as Apple Computer, Hewlett Packard, Quest, Intel, Google, Yahoo, and many others. San Jose is the largest city in the

County, with a population of nearly 900,000, and is the administrative site of County Government. The County operates under a home rule charter adopted by the voters of the County. Policymaking and legislative authority is vested in the County's Board of Supervisors, which consists of an elected supervisor from each of the County's five districts. The supervisors then hire the county executive who carries out the policies established by the board. The County's largest discretionary revenue source is property tax, which made up 67% of revenue in 2006.

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In billions*)



Pensions

Santa Clara County participates in the California Public Employees' Retirement System (CalPERS) for its pension benefits. The vesting criterion for pensions is five years of service credit under the system. Since June 1992, the benefit formula has been "2% at 55" for all miscellaneous (general) employees. Since 2001, the current benefit formula has been "3% at 50" for all safety employees (deputy sheriffs, correctional officers, probation officers, rangers, and investigators). Benefit formula changes are applicable to active and inactive employees who have not yet retired, and are applied prospectively as well as retroactively to service already earned

under the system. Only miscellaneous (general) and temporary employees participate in Social Security.

The County's annual contribution is determined by an annual actuarial valuation performed by CalPERS. The County pays both the employer and the employee (except for nurses) share of the annual pension contribution, as determined by CalPERS. Employer contributions more than doubled in the last ten years from \$84 million (1996/97) to \$228 million (2006/07), as a result of both lower investment earnings than anticipated and the higher pension formulas granted in 2001.

Pension costs are also a significant part of the County’s payroll costs. As shown in *Chart 2*, employer contributions have ranged from 6.24% (1999/00) to 18.9% (2006/07) of annual payroll costs.

As shown in *Chart 3*, in the last decade, pension costs as a percentage of the County’s total operating budget have ranged from 2.1% (2000/01) to 6.5% (2006/07).

The largest increase in pension costs came in 2004/05, when employer contributions increased by 70%. Santa Clara County benefited from the

“contribution holiday” instituted by the CalPERS Board in response to the positive investment earnings generated in the late 1990s. Santa Clara County’s employer rate was 0% for both miscellaneous and safety groups in fiscal years 1999/00, 2000/01, and 2001/02. The 0% rate continued in fiscal year 2002/03 for miscellaneous employees.

Retiree Health Care

The County of Santa Clara has provided health care benefits to its retirees since 1975. Current eligibility requirements for retiree health care is ten years

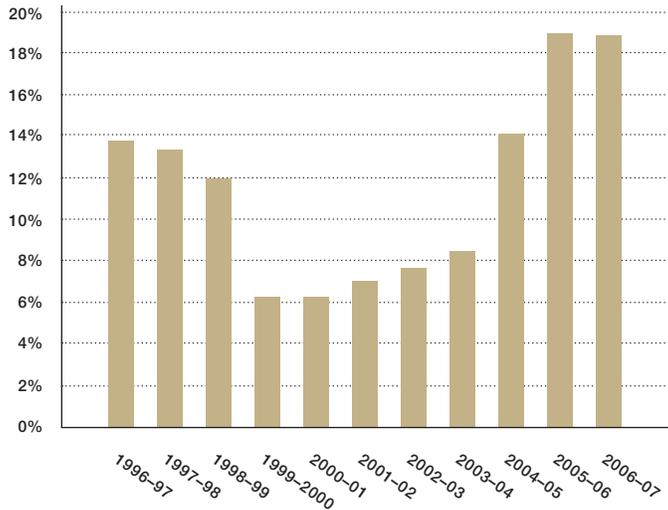


CHART 2:
Employer Pension Contribution as
a Percentage of Annual Payroll

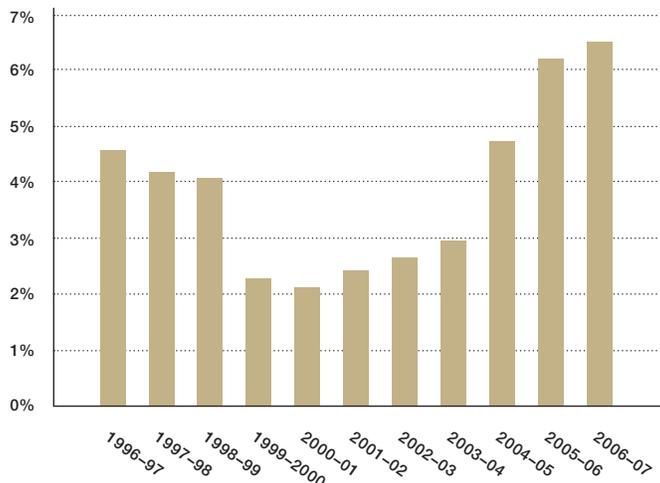


CHART 3:
Employer Pension Contribution as
a Percentage of Operating Budget

of employment with the County, participation in CalPERS, and direct retirement from the County at the minimum age of 50.

When benefits were first offered in 1975, they were funded on a pay-as-you-go basis; County costs for retiree health insurance were approximately \$58,000. By 1983, the annual cost of the benefit had grown to \$1.5 million. In 1984, the Board of Supervisors conducted an actuarial study to determine the full unfunded liability of the retiree health care benefit. The Board also incorporated the benefit into labor contracts and considered various options for reducing the future liabilities by stabilizing the cost of the retiree health benefit. Eligibility criteria were formally defined as the following:

1. Benefits are limited to the retiree alone;
2. Five years of service with the County is required, and the employee must directly retirement upon separation from the County; and
3. The employer contribution for retirees is limited to premium amount for the lowest-cost health plan available.

The initial 1984 actuarial study determined the unfunded liability to be \$21 million. The Board decided to prefund the benefit and established an annual payment of \$250 per active employee to be included in the general budget.

The Retiree Health Trust Fund was created as a separate trust fund under the County’s Treasury Division. Investment decisions are based on the County’s investment policy. As shown in *Chart 4*, investments in the Retiree Health Trust Fund have averaged a 6.7% rate of return since 2001.

Following the creation of the trust fund, no additional actuarial studies were conducted until 1991. The updated actuarial study identified a dramatic increase in the unfunded liability from \$21 million in 1984 to more than \$200 million. In seven years, the unfunded liability had grown tenfold due to medical premium inflation and increases in the number of retirees. The study recommended an increase in the amount budgeted per employee to \$1,200 per year. The County increased its budgeted prefunding contribution to \$900 per year.

In order to reduce future liabilities, the County has also instituted the following activities to address rising costs.

- In 1996, the County negotiated with labor groups to increase the required years of service from five to eight years. This reduced the liability by \$31.2 million.
- Following passage of AB 2764 in 1998, Santa Clara County received statutory authority to invest retiree health funds in a similar manner as

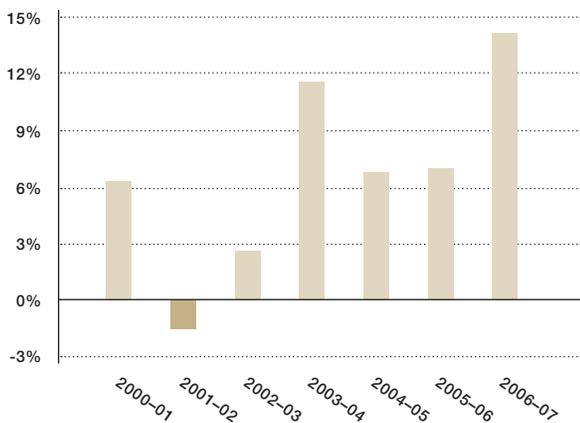


CHART 4:
Rate of Return on OPEB Investments

investments in defined benefit retirement systems, which has allowed increased rates of return on its assets.¹ The County has used mutual funds as a means of investing in equity markets.

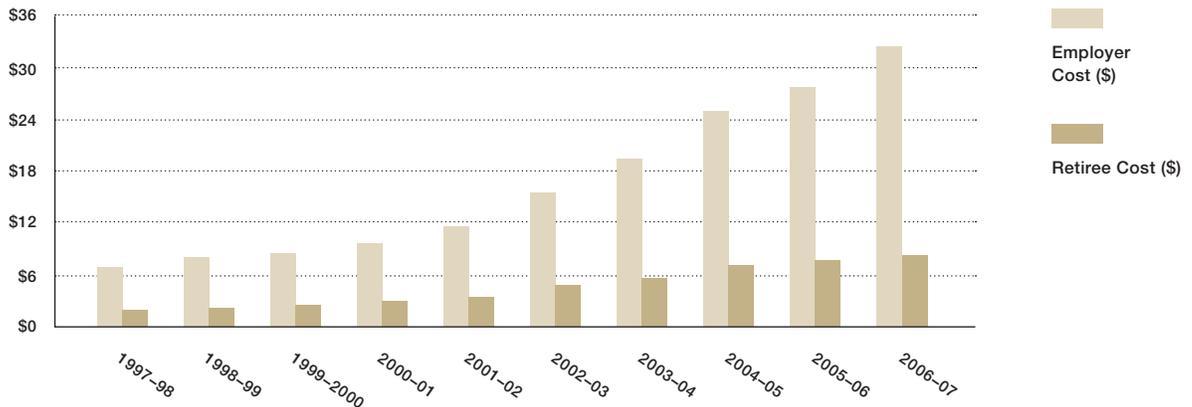
- In 2000, when CalPERS reduced many employer contribution rates to zero, the County deposited \$12 million into the OPEB prefunding account. These were savings due to a lower PERS contribution rate in the Retiree Health Trust Fund and reduced the amortization period from 30 years to seven years. The County also continued to pay the employee share. This reduced the unfunded liability to \$69 million, the lowest point since 1991.

Despite the above activities to reduce the unfunded liability, premium costs have risen over the last ten years for employers and employees resulting in overall increases in the County's OPEB obligations.

In 2002, the County's OPEB unfunded liability reached \$237 million. At that point, the Board returned to a 30 year amortization period. In 2004, facing a \$200 million budget deficit, the Board approved paying only the annual cost of retiree health benefits and temporarily suspending payments toward the unfunded liability. The County has committed that when its financial situation has stabilized, it will fund the normal cost of OPEB benefits and work towards the goal of eliminating the unfunded liability.

Current assets in the Retiree Health Trust Fund equal \$396 million, which represents 31% of future OPEB liability (actuarial accrued liability). In order to meet the requirements of GASB 45, Santa Clara County plans to set up an irrevocable trust by the end of fiscal year 2007/08 to ensure that funds can be used to offset the reportable OPEB liability. The County will serve as trust administrator.

CHART 5:
Health Care Premium Contributions (In millions)



¹ Authority for this action can be found in Government Code Sections 53620-53622, "Investment of Health Care Funds." Other public agencies also have the opportunity to invest funds pursuant to this section.

Case Study Profile: Trinity County

Type of Agency:	County
Number of Employees:	384 Active Employees; 234 Retired Employees
Revenue:	\$58,000,000 (2006/07)
Total Payroll:	\$33,701,606 (2006/07)
Participates in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Minimum age 50, with 5 years of service

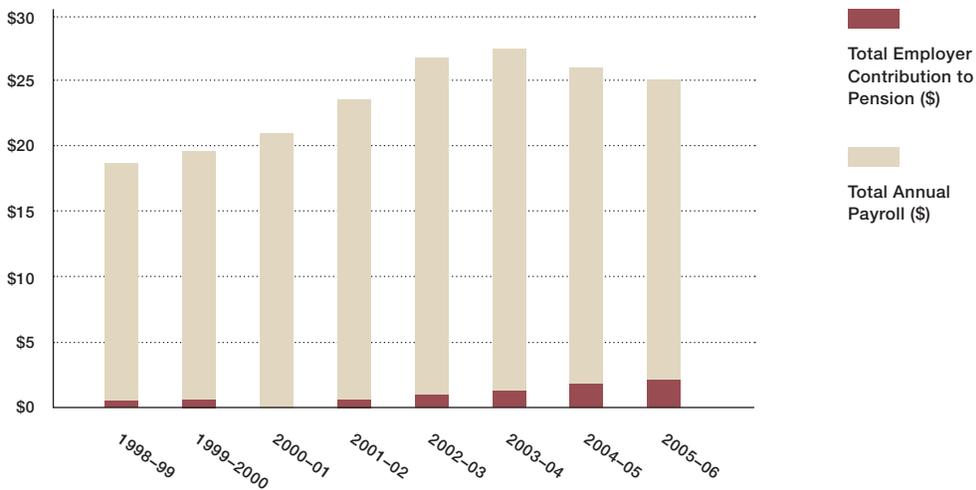
Background

Trinity County was established in 1850 as one of the original 27 counties making up the new state of California. Trinity County is a general law county with a board of supervisors/officer form of government. Under this type of government, the board of supervisors is the policy-making body, appointing the chief administrative officer who is responsible for carrying out the board's policies. Trinity County has a population of 14,313 and the primary source of revenue is derived from property tax.

Pensions

Trinity County is a participant in the California Public Employees' Retirement System (CalPERS) for pension benefits. The current benefit formula is "2% at 55" for all miscellaneous (general) employees and "2 at 50%" for safety employees. The current benefit formulas have been in place since 2001. On January 1, 2008, the safety formula will become "3% at 50." The County's annual employer contribution is determined by the annual actuarial valuation performed by CalPERS, and the County also pays the employees' retirement contributions. The pension

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



vesting criteria is five years of employment with any CalPERS-covered employer and retirement at 50 years of age or older. Trinity County participates in Social Security for both miscellaneous and safety employees.

Chart 1 presents Trinity’s employer pension costs in the context of total annual payroll. Since fiscal year 1998/99, Trinity’s employer pension costs have ranged from 0.12% to 8.95% of the County’s total annual payroll.

As demonstrated in *Chart 2*, the County’s historical pension costs, as represented by total employer contributions, range from 0.06% to 4.07% of the County’s total operating budget.

Retiree Health Care

Trinity County contracts with PEMHCA, the health care program administered by CalPERS, for health care for its active and retired employees. Benefits available to active employees include health care,

dental, vision, and life insurance. Retirees have access to health and dental benefits. The County considers health care benefits to be vested as a result of the PEMHCA law and bargaining agreements with employee groups. Any retiree who qualifies for a service or disability retirement is eligible for retiree health care benefits, provided that the individual retires within 120 days of separation from employment with the County.

In 2001, the Board of Supervisors, by resolution, made the employer contribution amount for retiree medical benefits the same as the County's contribution to an active employee, which is also a requirement of the PEMHCA program. The County pays 100% of the cost of individual coverage in the PERSCochoice medical plan. Any additional cost for the retiree, spouse, and/or dependent coverage is the responsibility of the retiree. The premium for active employees and retirees under the age of 65 is \$473.20, and for retired employees over the age of 65, the PERSCochoice supplement to Medicare plan premium is \$322.03 per month (based on 2007 health plan rates). The County also pays fixed monthly amounts for active and retired employees of \$40.00 for dental, \$8.61 for vision care, and between \$8.00 and \$16.00 for life insurance depending on employment classification. The benefits are paid for the life of the retired employee. The County does not contribute towards coverage of a surviving spouse after the retiree's death. The surviving spouse has

access to the benefits at the County's group rates but must pay the full premium cost.

In early 2006, Trinity County initiated its first OPEB actuarial report in recognition of the rise in pay-as-you-go costs and at the request of the Auditor's Office which asked the Board of Supervisors to begin funding the liability. On July 1, 2006, Trinity County began to fund OPEB benefits by about \$1.6 million per year in order to defray pay-as-you-go costs. In March 2007, the actuarial report was completed and identified an unfunded OPEB liability of \$48.8 million (with a discount rate of 7.5%) and an annual required contribution (ARC) payment of \$5,806,288. The County is now in the process of determining whether it has the means to pay the ARC.

On June 20, 2006, the Board of Supervisors approved the Public Agency Retirement Services (PARS) trust to provide both a funding vehicle and consulting and support services related to the County's OPEB funding obligation. According to Trinity County, PARS was chosen as the trust administrator because the County wanted to move quickly to address its financial liability. The CalPERS trust was not yet available, and PARS well-established trust program ready to accept funds. The PARS trust is a multiple employer trust, allowing the County to join with other public agencies for investment and administrative economies of scale. The PARS program provided signature-ready master documents

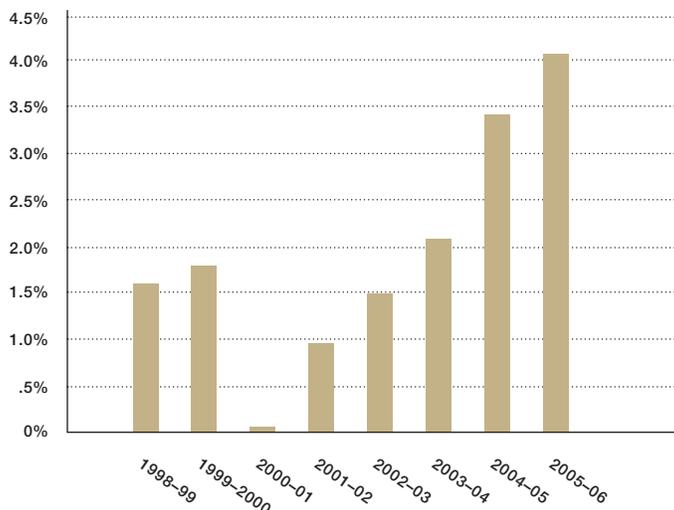


CHART 2:
Employer Contribution as
a Percentage of Operating Budget

for IRS approvals. This minimized the legal and administrative costs compared to starting up an independent trust, especially for a small county like Trinity.

Also, although a multiple employer trust, the PARS trust allows for local control and customization for each participating agency. Each agency selects an investment strategy, in which funds are pooled and the strategy is managed on a discretionary trustee basis by Union Bank of California. The County selected a moderate investment strategy, which allows for a strategic range of 40 - 60% equities and 40 - 60% fixed income, with a targeted long-term rate of return of 7 - 8%.

In January 2007, Trinity County deposited \$102,000 into a PARS' 115 Trust. Subsequent monthly deposits have brought the current total to \$312,000, as of October 2007. Although no specific policy has been established, Trinity plans to continue making monthly contributions without taking disbursements for the near future.

Background on PARS' 115 Plan

Trinity County is enrolled in an IRS 115 multiple employer prefunding trust program for OPEB benefits, which is administered by Irvine, California-based Public Agency Retirement Services (PARS). PARS administers several of the largest local agency-controlled qualified retirement trust programs in the United States, comprised of more than 450 member public agencies and 743 plans. Its programs cover more than 270,000 public employees, primarily located in California and the Southwest. PARS was established in 1983 as a private, for-profit company to provide California public employers with supplemental retirement plans, such as early retirement incentive plans, alternatives to Social Security, and retirement enhancement plans. In 1996, PARS began administering its first trust for public agencies to prefund OPEB costs. PARS also administers the California School Boards Association's GASB 45 Solutions Trust Program available to educational agencies in California.

Case Study Profile: Alameda County Mosquito Abatement District

Type of Agency:	Special District
Number of Employees:	13 Active Employees; 11 Retired Employees
Revenue:	\$2,266,000 (projected 2007/08) plus a \$900,000 carry over from 2006/07
Participates in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Employees hired on or after November 2003 must retire within 120 days of separation from employment with the District and have ten years of service credit with the District to be entitled to any employer contribution. With 10 years of service, an employee receives 50% of the employer contribution. The benefit increases to 100% of the employer contribution with 20 or more years of service.

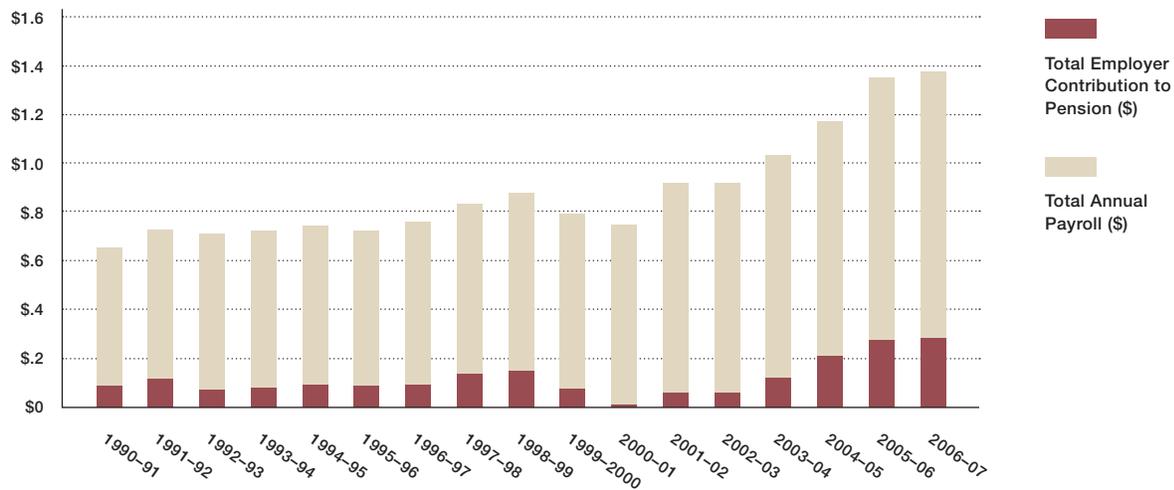
Background

The Alameda County Mosquito Abatement District (ACMAD) was formed on March 11, 1930 and is headquartered in Hayward. It is governed by a fourteen member board of trustees. It provides services to communities in an area ranging from Berkeley to the north, Fremont to the south, and as far east as Livermore. The total area of coverage is 810 square miles. The District's principle source of revenue is property tax and a special tax of \$1.74 per residence per year. Projected revenues for the 2007/08 fiscal year are estimated to be \$2,266,000, plus a cash carryover from the previous fiscal year of \$999,000.

The employees are represented by an employee association for wage and benefit negotiations. The workforce has an average age of 45.8 years, and the average length of service is 11 years. All but three individuals have less than 20 years of service with the District. In the last eight years, four individuals have retired.

Although small in size, the District is typical of a large number of special districts which contract with CalPERS for retirement and health care coverage. According to the CalPERS Annual Financial Report (dated June 30, 2006), there are 1,001 special

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



districts that contract for retirement coverage. Most of these districts, 511 or 51%, have 20 or fewer employees. Of the 511 smallest special districts, 193 districts provide the “2% at 55” retirement formula; 188 districts provide the “2% at 60” retirement formula; 89 districts provide one of the three higher retirement formulas (i.e. “2.5% at age 55,” “2.7% at age 55,” or “3% at age 60”); and the 41 remaining districts are fire districts with no miscellaneous employees.

Pensions

ACMAD initially contracted with CalPERS for retirement coverage on January 1, 1946. In order to receive a retirement benefit, employees must have five years of service and a minimum age of 50. In 1992, the District increased the benefit formula offered to miscellaneous employees to “2% at 5.” To calculate the retirement benefit, a one-year final compensation period is used. Employees are also able to convert unused sick leave into retirement service credit if the employee retires immediately after separating from employment with the District. Upon death, the

surviving spouses of District retirees are also eligible for special survivor benefits.

Employees hired after 1986 are subject to mandatory Medicare coverage, but the agency is not otherwise subject to Social Security coverage.

The District's employer contribution rate for pension benefits is 19.801% for fiscal year 2007/08. In addition, the District pays the employees' retirement contributions.

Chart 1 provides a history of the total employer contribution rate from 1990/91 to 2006/07.

Because it has fewer than 100 employees, on July 1, 2005, the Alameda County Mosquito Abatement District was included in one of the risk pools created by CalPERS to stabilize small employer contribution rates. The District's risk pool has a common retirement formula and is 99.8% funded as of the last valuation. Prior to joining the risk pool, the District's retirement plan was 83% funded. The unfunded liability was the result of the decline in asset value partially caused by the stock market decline in 2002 and 2003.

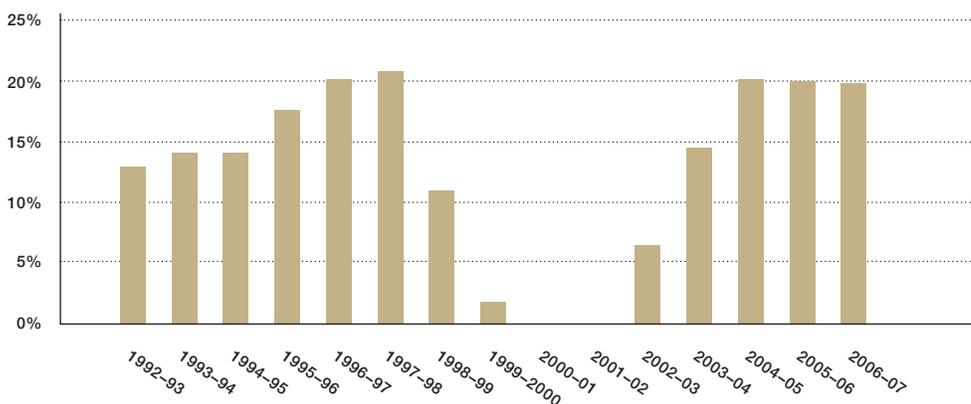
When employers were merged into common risk pools, CalPERS established "side funds" for each agency to account for existing surplus assets or unfunded liabilities. Consequently, there is a common employer contribution rate for all members

of the risk pool and a separate employer contribution rate attributable to each agency's side fund. If an agency had an unfunded liability when the risk pools were created, that unfunded liability remained with that employer and is not subsidized by other employers in the risk pool. Also, if an agency adds an optional benefit not mandated by the risk pool, an additional contribution for the optional benefit would be added to that employer's rate. In effect, each agency within a risk pool can have a separate employer contribution rate while sharing overall risk.

Alameda County Mosquito Abatement District's unfunded liability, as of the June 30, 2005 valuation, was approximately \$1.1 million, and the District's plan had an 83% funded ratio. The employer contribution rate attributable to the unfunded liability went from 6.7% on July 1, 2004, to a high of 12.357% on July 1, 2005, and it was 11.219% as of July 1, 2007.

Chart 2 displays total contributions paid by the District as a percentage of annual payroll, while *Chart 3* shows the total amount of those contributions. The amount paid is directly impacted by the size of the District's payroll. In lieu of salary increases, ACMAD agreed to pay 3% of the employee's retirement contribution beginning in the 1999/00 fiscal year. During the 2000/01 fiscal year, the District began paying 6% of the employee contribution, and the District has been paying the

CHART 2:
Employer Retirement Contribution as a Percentage of Annual Payroll



full 7% employee contribution rate since 2001/02 fiscal year. The chart reflects the total employer contributions paid by the District, as well as the additional amount for the employees' retirement contributions.

7.66%. The retirement contributions reflected in this chart are only those required by CalPERS and do not include the employee contributions paid by the District since the 1999/00 fiscal year.

Charts 4 and 5 display the extent employer-paid retirement contributions impact the operating budget. As a percentage of the operating budget, the highest level occurred during the 1991/92 fiscal year at 8.08%. In the 2006/07 fiscal year, it was

Retiree Health Care

The District provides health coverage for its active and retired employees through the CalPERS health program, PEMHCA. The District pays 100% of single-party coverage, 90% of two-party coverage,

CHART 3:
Employer Retirement Contributions (In thousands)

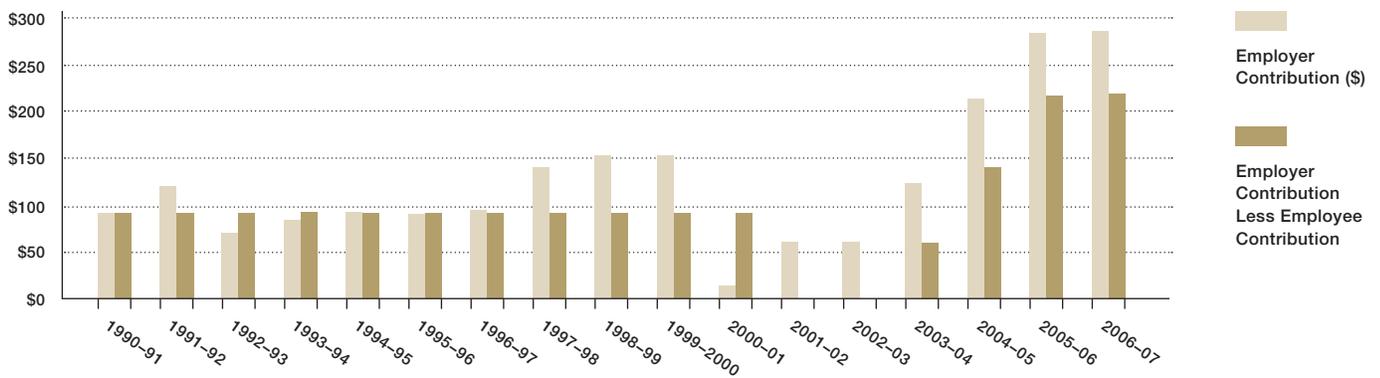
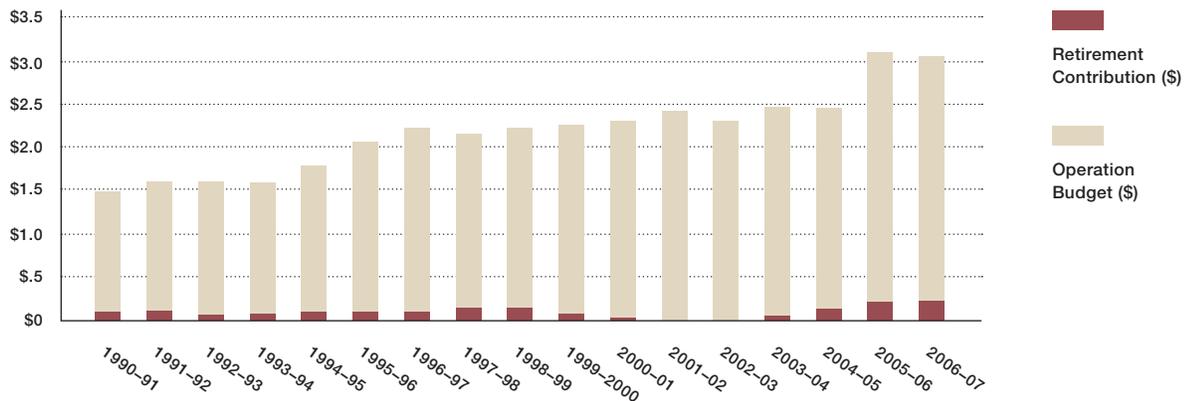


CHART 4:
District Retirement Contributions in Relation to the Operating Budget (In millions)



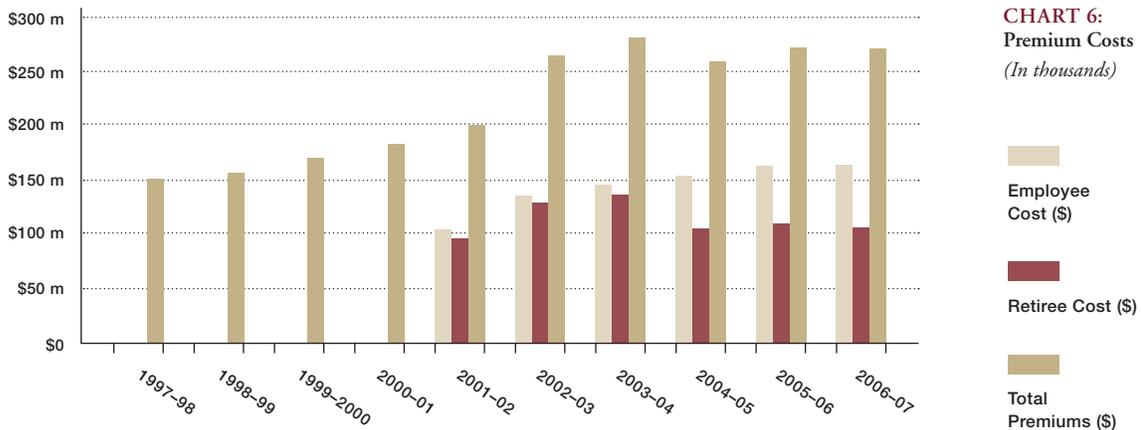
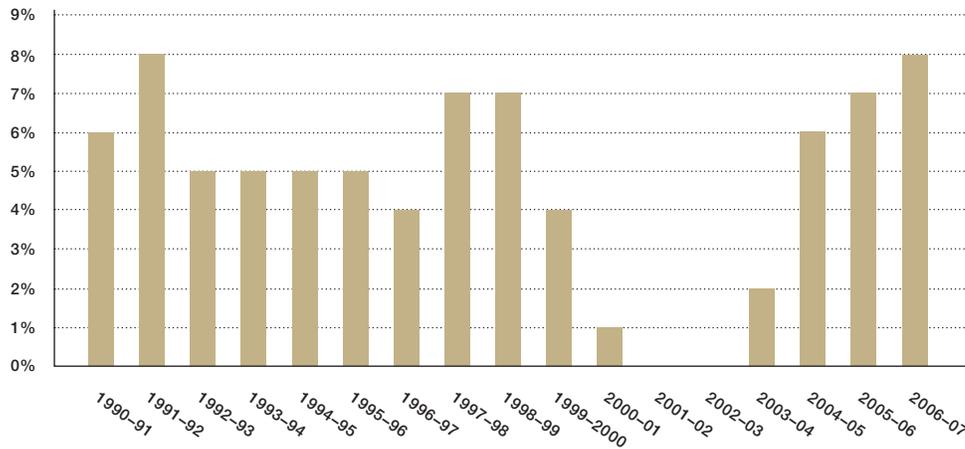
and 90% of family coverage based on the premium rates for the Kaiser plan available in the San Francisco Bay/Sacramento area.

An employee is eligible for retiree health benefits provided that she is also eligible for a pension benefit and retires within 120 days of separation from employment with the District. There is no minimum service requirement with the employer in order to receive the employer contribution towards that coverage. ACMAD adopted a resolution to require individuals hired after November 2003 to earn 10 years of service, five years of which must be

with the District, to become eligible for an employer contribution toward retiree health plan coverage. Retirees who do not meet the five year minimum service requirement with the employer, or who retire with less than ten years of service, have access to PEMHCA health coverage but must pay the full cost of health plan premium.

Those hired prior to November 2003 are eligible for the employer contribution toward retiree health benefits once they are eligible to retire, regardless of their length of service with the District.

CHART 5:
Employer Retirement Contribution as a Percentage of Operating Budget



In 2007, the District's monthly employer contribution is \$431.17 for retiree-only, \$819.22 for two-party coverage, and \$1,052.05 for family coverage. The following chart demonstrates the change in employer cost, retiree cost, and total premium. Because the District has a small number of retirees, retiree health costs can vary significantly, even as a result of one additional retirement.

Because it is of such small size, the District will be one of the last employers required to implement GASB 45. The District is paying retiree health premiums on a pay-as-you-go basis, but anticipates implementation of some sort of prefunding approach when it becomes necessary to report its GASB liability.

Case Study Profile: Sacramento Municipal Utilities District

Type of Agency:	Special District
Number of Employees:	2,026 Active Employees; 1,338 Retired Employees
Revenue:	\$1,354,427,000 (2006)
Total Payroll:	\$180,493,963 (2006)
Participates in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Five years of service; minimum age of 50

Background

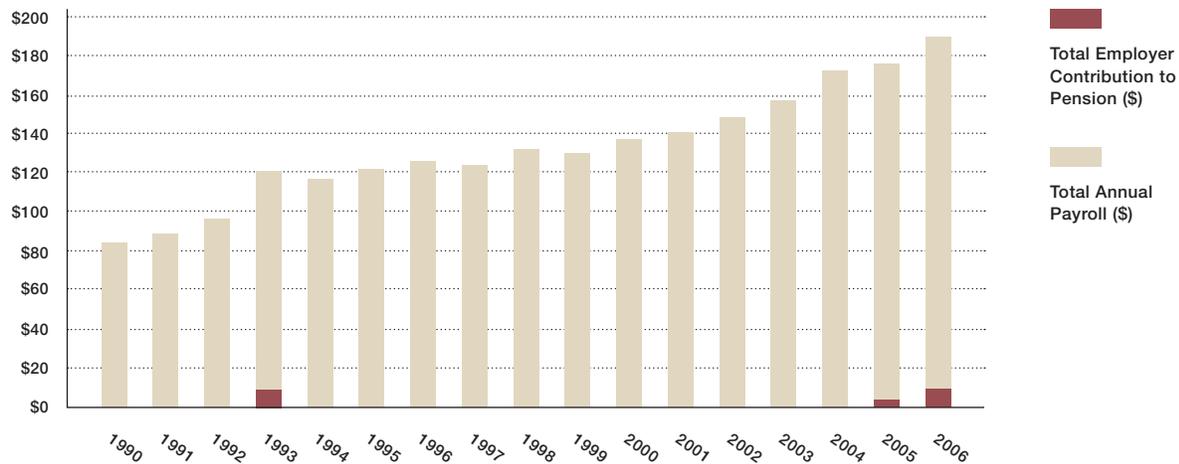
The Sacramento Municipal Utility District (SMUD) is the nation's sixth largest community-owned electric utility in terms of customers served. SMUD served 585,221 customers in 2006. SMUD was established by a popular vote in 1923, under provisions of the State of California Municipal Utility District Act, and began electric operations in 1947. SMUD is governed by an elected board of directors and has the rights and powers to fix rates and charges for commodities or services furnished, to incur indebtedness and issue bonds or other obligations, and, under certain circumstances, to levy and collect property tax. SMUD is responsible for the acquisition, generation, transmission, and distribution of electric power to

its service area, which includes most of Sacramento County and a small adjoining portion of Placer County.

Pensions

SMUD is a participant in the California Public Employees' Retirement System (CalPERS), a multi-agency retirement system. The current pension benefit formula is "2% at 55" for all employees. This benefit formula was adopted in 2000 and enhanced the retirement benefit for all active and former employees. Prior to 2000, the benefit formula was "2% at 60" and had been in place since 1971.

CHART 1:
Employer Pension Contributions as a Proportion of Total Annual Payroll (*In millions*)



The retirement contribution for active employees is 7% of salary. This amount is picked up by SMUD as part of collective bargaining agreements, with the exception of those employees represented by the International Brotherhood of Electrical Workers (IBEW). Employees represented by IBEW currently pay a portion of the 7% employee contribution, although this will be entirely paid for by SMUD by 2010, pursuant to the current bargaining agreement. SMUD employees do participate in Social Security. SMUD does not employ any safety employees.

Chart 1 shows SMUD’s pension costs as represented by total employer contributions. It is important to

note that between calendar years 1994 and 2004, SMUD made no employer contributions. This contribution holiday was largely due to reductions in the annual required contribution (ARC) resulting from the high investment earnings during the late 1990s. For local agencies, there is a two-year lag at CalPERS between the completion of an actuarial valuation and the setting of employer contribution rates based on that valuation. That lag, combined with the effect of multiple-year smoothing of gains and losses, explains the continued lack of employer contributions seen in calendar years 2001 through 2004, after the stock market downturn.

Chart 2 shows that same employer pension contribution as a percentage of annual payrolls. This chart does not reflect SMUD's pick-up of the employee contribution.

As shown in *Chart 3*, historical pension costs for SMUD, as represented by total employer contributions, range from 0% (several years) to 2% (1993) of SMUD's total operating budget.

Retiree Health Care

Benefits available to active employees include health, dental, vision, death/disability, and life insurance. Retirees have access to health and dental benefits.

Health care benefits are considered vested due to statute and bargaining agreements with employee groups.

SMUD has three classifications of employees, including those represented by the Organization of SMUD Employees (OSE), those represented by the International Brotherhood of Electrical Workers (IBEW), and unrepresented employees. The current premium for the basic health care plan is \$379.76 per month for the employee only. Although there are two tiers for active employees based on hire date, SMUD pays 80% to 98% of the health care pre-miums for all three employee groups and both tiers.

There are three tiers for retiree health benefits that differ somewhat between the three bargaining groups.

CHART 2:
Employer Pension Contribution as a Percentage of Annual Payroll

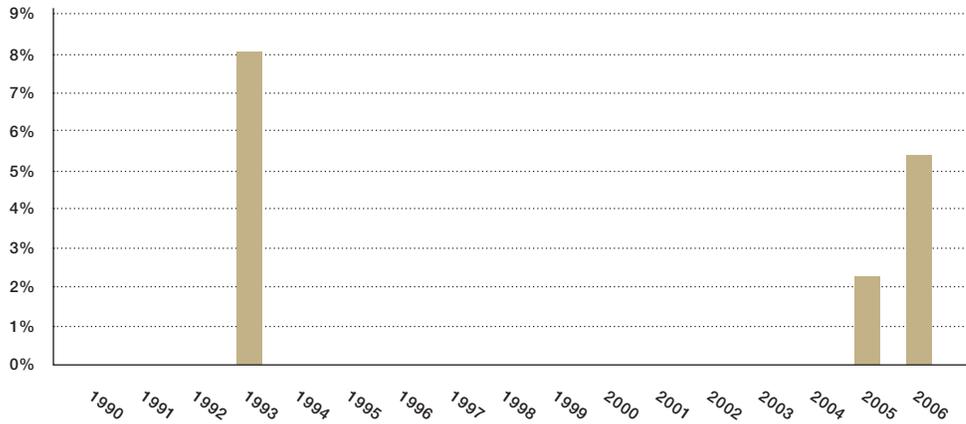
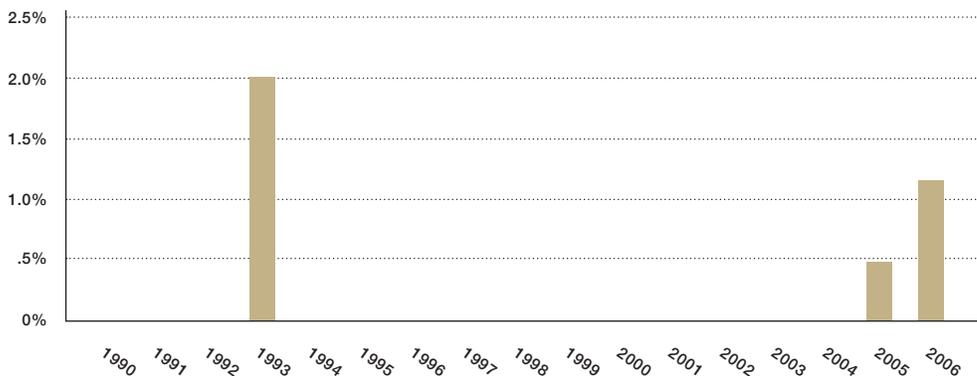


CHART 3:
Employer Pension Contribution as a Percentage of Operating Budget



Eligibility criteria for all employees is five consecutive years of employment with SMUD and retirement from SMUD at 50 years of age or older. Eligibility is not based on whether they have retired under CalPERS.

Tier 1 employees receive an employer contribution of 100% of the health care premium for the retiree-only, and 85% to 95% for dependents, depending on the health plan selected.

The Tier 2 and Tier 3 employer contributions are based on a percentage of the amount SMUD contributes for a Tier 1 retiree.

Tier 2 employees receive an employer contribution for retiree health benefits based on the following percentages:

- Retirees with less than 10 years of service receive 0%.
- Retirees with 10 to 19 years of service receive 50% to 95%, prorated based on years of service.
- Retirees with 20 or more years of service receive 100%.

Tier 3 employees receive an employer contribution for retiree health benefits based on the following percentages:

- Retirees with less than 10 years of service receive 0%.
- Retirees with 10 to 19 years of service receive 25% to 47.5%, prorated based on years of service.
- Retirees with 20 to 25 years of service receive 50% to 75%, prorated based on years of service.

IBEW represented employees fall into the following three tiers:

- Tier 1 employees hired prior to January 1, 1991;
- Tier 2 employees hired on or after January 1, 1991; and
- Tier 3 employees hired on or after January 1, 2007.

OSE represented employees fall into the three tiers as follows:

- Tier 1 employees hired prior to July 1, 1991;
- Tier 2 employees hired on or after July 1, 1991; and
- Tier 3 employees hired on or after January 1, 2006.

Unrepresented employees fall into the three tiers as follows:

- Tier 1 employees hired prior to January 1, 1993;
- Tier 2 employees hired on or after January 1, 1993; and
- Tier 3 employees hired on or after January 1, 2007.

Changes in eligibility criteria were implemented as part of efforts to reduce future OPEB liabilities.

As illustrated in *Chart 4*, the total premium cost for SMUD's retiree health care benefits have increased dramatically over time.

Although SMUD has completed actuarial reports and realized some time ago that prefunding would reduce its OPEB liability, SMUD was not in a position to start prefunding until 2007. An actuarial report

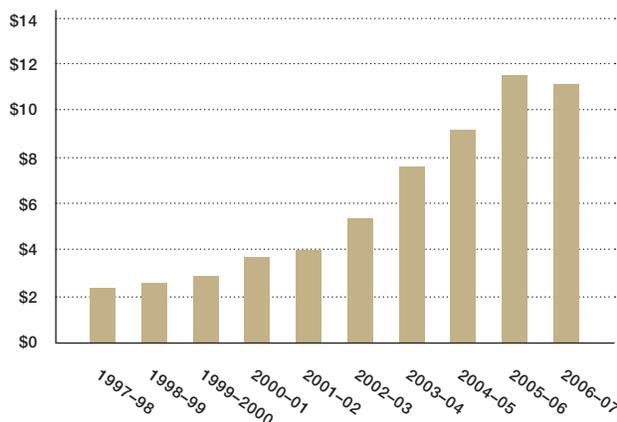


CHART 4:
Premium Costs for Retiree Health Care
(In millions)

completed in 1999 identified an unfunded liability of almost \$105 million. In contrast, the most recent actuarial report identified a \$262.5 million unfunded OPEB liability with an annual required contribution (ARC) of \$23.7 million, using a 7.1% discount rate. SMUD realized that without prefunding its accrued liability would continue to grow in future years.

In January 2007, SMUD set up an interim prefunding reserve account. The funds in the account are commingled with other assets so the funds cannot be used to offset OPEB liabilities. SMUD has built prefunding into the general budget, and money from general customer revenue is used to

fund the reserve account. From January 1, 2007 to July 31, 2007, SMUD deposited \$13.8 million into the special revenue account and used \$5.8 million of these funds to pay for monthly OPEB costs. SMUD will continue to fund at the current level of \$1.9 million per month and is in the process of having another actuarial report completed for 2007 using the assumptions and methodologies required by the CalPERS prefunding program.

SMUD plans to review the option of establishing a trust with CalPERS and the option of setting up a 115 trust account using a third-party trustee for asset management.

Public Employee
Post-Employment
Benefits Commission

Section I:
Sacramento
Municipal Utilities
District

Case Study Profile: Western Municipal Water District

Type of Agency:	Special District
Number of Employees:	124 Active Employees; 30 Retired Employees
Revenue:	\$93,000,000
Total Payroll:	\$9,000,000
Participates in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Twelve years of employment, retirement directly from the District at the minimum age of 55

Background

Western Municipal Water District was formed in 1954 to bring supplemental water to growing Riverside County. The District serves more than 22,000 retail and wholesale customers. The District consists of a 527-square mile area of western Riverside County. It is governed by a board of directors and has a total of 124 active employees and 30 retirees.

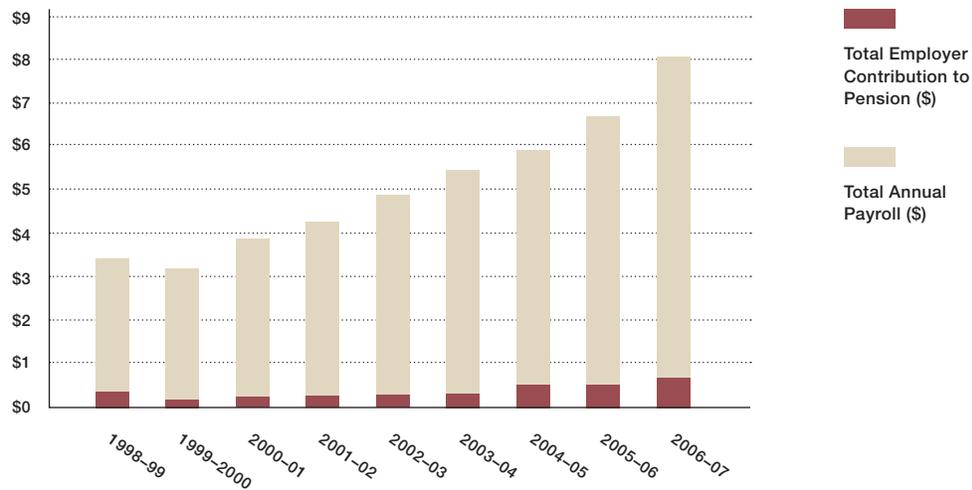
Pensions

Western Municipal Water District participates in the California Public Employees' Retirement

System (CalPERS). The current benefit formula is "2.5% at 55." In July 2007 after the board of directors conducted a salary survey to determine competitiveness, it decided to increase pension benefits from the "2% at 55" formula. Pensions are considered vested if the employee completes at least five years of service credit. A member can retire as early as the age of 50. The District pays all of the required member contributions on behalf of the employees.

Chart 1 compares the District's total employer pension contributions to its total annual payroll. As seen in *Chart 2*, the District's employer pension

CHART 1:
Employer Pension Contribution as a Proportion of Total Annual Payroll (*In millions*)



contributions have historically ranged from 5.96% (2003/04) to 12.61% (1998/99) of payroll.

Total employer contributions for pensions, as seen in *Chart 3*, have historically ranged from 0.47% (several years) to 0.91% (1998/99) of the total operating budget.

Retiree Health Care

The District provides medical benefits for active and retired employees through the same health plans, meaning active and retired employees share a risk

pool. Employer contributions for health benefits are currently capped at \$1,187 per month for active employees and \$743 per month for retired employees. The District purchases health insurance from the Association of California Water Agencies (ACWA).

There is a two-tier system: employees who were hired prior to December 2002 and retire after age 55 with at least twelve years of service receive an employer contribution adequate to cover the premiums of an “employee plus one” medical benefit plan. If hired after December 2002, the employer contribution only covers the premiums for an employee-only medical benefit plan.

The \$743 that the District contributes for retiree health benefits corresponds to the premium required for “employee plus one” coverage under the lowest cost health plan offered to active employees. If the retired employee chooses a higher priced plan, then the retiree pays the difference.

Historically, the District funded retiree health care on a pay-as-you-go basis. From 1999 to 2005, the annual cost of retiree health care increased almost 150%, from \$45,313 to \$111,384. In 2005, the Board commissioned an actuarial study of the

District’s OPEB liabilities in order to meet GASB requirements. The study identified an unfunded actuarial accrued liability (UAAL) of \$5.8 million.

In 2006, the District’s board of directors approved full prefunding of the liability and placed \$5.8 million into a voluntary employees’ benefits association (VEBA) trust. The board’s decision to create a VEBA was based on a high priority to retain loyal employees.

A VEBA is a tax-exempt trust whose funds are used to pay eligible medical expenses. The membership

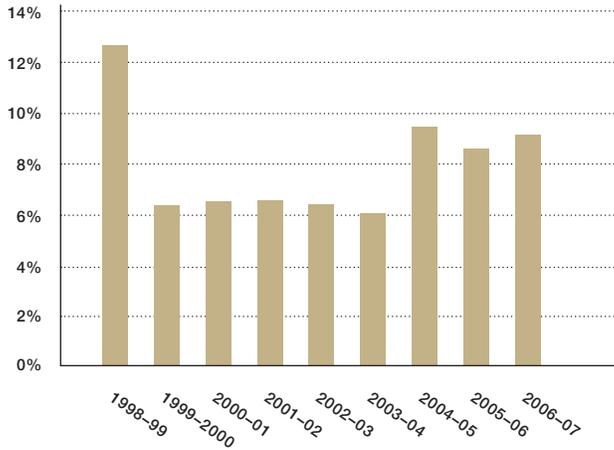


CHART 2:
Employer Pension Contribution as a Percentage
of Annual Payroll

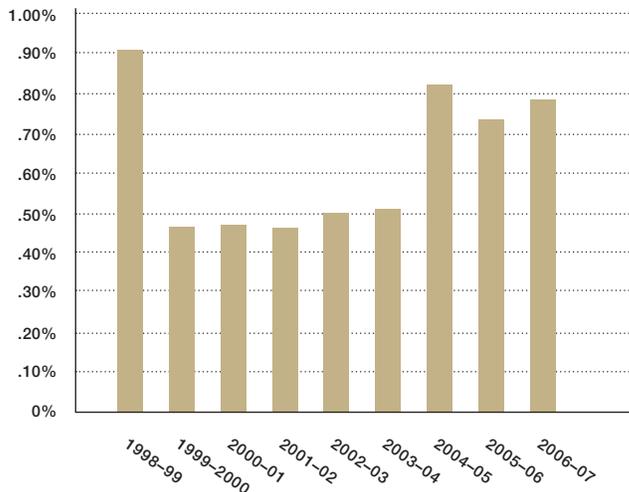


CHART 3:
Employer Pension Contribution as a Percentage
of Operating Budget

of a VEBA “must consist of individuals who have become entitled to participate by reason of being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals.” All employee contributions are on a pre-tax basis, and contributions are allowed to grow tax-free in individual accounts. In the case of Western Municipal, the VEBA accounts are set up by employer for the benefit of employees.

US Bank manages all investments for the District’s VEBA account. All administration and development costs are borne in-house by the District. Since initially prefunding in 2006, the Board has paid the annual required contribution (ARC) for the 2007 fiscal year, which was determined to be \$306,187. The District is considered 100% prefunded, and therefore reports no OPEB liability according to GASB rules.

Multi-Agency Medical Trust Profile: Central Valley Retiree Medical Trust

Type of Plan:	Multiple Employer, Multiple Bargaining Unit, Individual Retiree Medical Reimbursement Trust
Participating Agencies:	Stanislaus ('37 Act system) and Tuolumne (CalPERS) Counties
Participating Bargaining Units:	Stanislaus County Deputy Sheriffs Association; Tuolumne County Deputy Sheriffs Association; Tuolumne County Management Association.
Number of Employees Covered by Trust:	720 Active Employees; 11 Retired Employees

Background

Tuolumne County provides active and retiree health care through the Public Employees' Medical and Hospital Care Act (PEMHCA) administered by CalPERS. PEMHCA allows the employer contribution amount toward employee/retiree and dependent coverage to differ by collective bargaining unit. Tuolumne County has seven collective bargaining agreements, and it provides an IRC 125 cafeteria plan for active employees in each of its bargaining units. The minimum amount the County contributes toward the cafeteria plan (other than the Deputy Sheriffs' Association) differs by bargaining unit, but it generally provides between \$1,000 and \$1,055 for employee-only coverage. For employees with one or more dependents, the County contributes an amount equal to the cost of health (PERS Choice PPO), dental, and vision insurance

(approximately \$1,355). The Deputy Sheriff's Association (DSA) memorandum of understanding provides for an employer contribution in a fixed dollar amount (\$1,100 for calendar year 2007 and \$1,200 for calendar year 2008) for each member of the DSA.

The County pays the minimum contribution required under PEMHCA (Government Code Section 22892) for all retirees (\$80.80 per month for calendar year 2007) other than for the excluded/confidential Unit. The retirees from this unit receive an employer contribution equal to 50% of the weighted average of the CalPERS health plan premiums available to active state employees (also known as the 100/90 formula), if they have at least 10 years of CalPERS service (with at least 5 years with the County). The employer contribution

percentage increases in 5% increments for each additional year of service, until the percentage reaches 100% with 20 years of service.

The bargaining agreements for the Deputy Sheriffs Association and the Management Unit require a County contribution into the Central Valley Retiree Medical Trust to help pay the share of future retiree health plan premiums that will be paid by the retiree. In one agreement, the amount of the County contribution to the trust is derived from a partial cash-out of unused sick leave upon retirement, while the other agreement calls for the County to make a monthly or biweekly contribution of a percentage¹ of pay into the trust. The trust was entered into in 2003. Participation is mandatory for the 120 deputies. There are no retirees receiving a benefit from the trust at this time.

Stanislaus County provides health coverage for its active workforce through direct contracts with Kaiser and PacifiCare. The health coverage includes active employees and their family members. In 2007, the County provided an employer contribution of \$210.26 for the employee, \$410.52 for the employee plus one dependent, and \$567.69 for the employee and family coverage. Retirees have access, at their own expense, to the group health plan and are allowed to obtain coverage at the same cost as active employees, meaning that retirees participate in the active employee risk pool. Stanislaus County does not provide an employer contribution for retiree health benefits.

Stanislaus County has twelve collective bargaining units, three of which (the Sworn Deputy Sheriffs' Association, the Deputy Sheriffs Supervisors' Association and the Sheriffs' Management

Association) participate in the medical reimbursement trust. The County contributes 1% of payroll of the Sheriffs' Management Association members into the trust, but does not make a contribution for the other two bargaining units. Members of the other two bargaining units can individually contribute to the trust.² Participation in the trust is voluntary for the members of all three bargaining units.

Independent Medical Trust

The independent retiree medical trust, rather than the employer, is responsible for decisions concerning eligibility, administration, claims payment, and investments, as well as for the issues of tax liability, federal and state reporting, and compliance responsibilities. The employer, through collective bargaining, agrees on a contribution amount, if any (a trust can be created that is totally employee contributory), that it will pay into the trust on behalf of each active member for future health care in retirement.

In return, an independent trust is established which oversees the collection of contributions and the reimbursement of medical expenses for eligible retirees using non-taxable dollars. Although these trusts do not have to meet GASB standards, they must comply with ERISA requirements.³

In discussions with the labor groups which worked to develop these retiree medical trusts, they indicated that the invested contributions will provide better benefits for their members. Because these trusts are beyond the control of the employer, the labor groups see these medical trusts as tools to guarantee their members health care in retirement.

¹ The IRS has apparently indicated that an employer contribution based upon a percentage of an employee's pay is discriminatory. The employer contribution may be changed to a fixed dollar amount in order to meet the IRS concerns.

² The IRS has apparently indicated that an employer contribution based upon a percentage of an employee's pay is discriminatory. The employer contribution may be changed to a fixed dollar amount in order to meet the IRS concerns.

³ ERISA refers to the Employee Retirement Income Security Act, federal law governing private pension systems.

Multi-Agency Medical Trust Profile: North State Public Safety Retiree Medical Trust

Type of Plan:	Multiple Employer, Multiple Bargaining Unit, Individual Retiree Medical Reimbursement Trust
Participating Agencies:	City of Chico (CalPERS), City of Novato (CalPERS), and Calaveras County (CalPERS)
Participating Bargaining Units:	City of Chico Police Officers Association; City of Novato Police Officers Association; Novato Police Managers Association; Novato Police Civilian Employees' Association; Calaveras Deputy Sheriffs Association
Number of Employees Covered by Trust:	221 Active Employees; 46 Retired Employees

Background

The City of Chico provides health coverage through Blue Cross for its active employees and their family members. The employer contribution toward health coverage is determined through collective bargaining. City retirees have access to the group health plans at the same rate as active employees, but must pay the entire cost of the premium of the plan they choose. Chico has eight collective bargaining agreements. One bargaining unit, the Chico Police Officers Association, includes in its memorandum of understanding (MOU) an employer contribution into the North State Public Safety Retiree Medical Trust to help pay the cost of future retiree health care premiums. Chico contributes to the trust \$200 per month per active police officer, including those who promote to positions not subject to the collective bargaining agreement. There are 94 active and 2 retirees covered by the trust.

The City of Novato contracts with CalPERS for health coverage under the Public Employees' Medical and Hospital Care Act (PEMHCA) for all eight bargaining units. Novato provides an employer contribution for active employees that ranges between \$725 and \$875 (depending on bargaining agreement) into a cafeteria plan. Employees can use the cafeteria plan funds toward the cost of various benefits, which allows the employee to choose how to allocate those funds. Any left-over funds are payable to the employee. Novato current provides the minimum employer contribution (\$80.80 for 2007) toward retiree health premiums. The bargaining agreements of two units, the Novato Police Officers Association and the Novato Police Civilian Employees' Association, require the City to pay into the trust \$100 and \$75 per month, respectively, per bargaining unit member. Novato is discussing whether to expand

participation in the trust to include the Novato Police Managers Association. There are 75 active employees and 4 retirees in the trust. There are no retirees currently receiving a benefit from the trust because of a ten year period between the formation of the trust and when payments will begin.

Calaveras County provides health coverage through Blue Cross and has a Section 125 cafeteria plan which allows the employees to apply the employer contribution toward health, dental, and vision plans as they see fit. Any funds in the cafeteria plan not used to pay premiums are available to the employee as cash. The County contributes \$415 for the employee, \$815 for an employee and one dependent, or \$1,080 for an employee plus family. The County provides an employer contribution of \$16 per retiree per month, and the retiree pays the balance of the premium cost. There are approximately 40 retirees receiving an employer contribution. There are three bargaining units in the County. The 52 employees represented by the Sheriffs' Deputy Association must participate in the trust. Each deputy contributes \$1200 per year into the trust, and there is no employer contribution.

The North State Public Safety Retiree Medical Trust anticipates expanding to include additional public agencies and to include other fire and non-safety employees who are considered first responders.

Provisions of the Trust

Vesting: 10 years from start of program or employment hire date, whichever is longer.

Trust Benefits: Based upon actuarial studies, retirees would have received a monthly benefit of \$150

per month for 2007. Benefits coverage is for: (1) premiums for health, dental, or vision insurance plans; (2) medical expenses not covered by insurance; and (3) long-term care insurance premiums.

Plan operations: Under the control and guidance of a six-member Board of Trustees; utilizes an outside third-party administrator for the payment of claims.

Independent Medical Trust

The independent retiree medical trust (rather than the employer) is responsible for decisions concerning eligibility, administration, claims payment, and investments, as well as the issues of tax liability, federal and state reporting, and compliance responsibilities. The employer, through collective bargaining, agrees on a contribution amount, if any (a trust can be created that is totally employee contributory), that it will pay into the trust on behalf of each active member for future health care in retirement.

In return, an independent trust is established which oversees the collection of contributions and the reimbursement of medical expenses for eligible retirees using non-taxable dollars. Although these trusts do not have GASB standards, they must comply with ERISA requirements.¹

In discussions with labor groups which worked to develop these retiree medical trusts, they indicated that the invested contributions will provide better benefits for their members. Because these trusts are beyond the control of the employer, the labor groups see these medical trusts as tools to guarantee their members health care in retirement.

¹ ERISA refers to the Employee Retirement Income Security Act, federal law governing private pension systems.

Section II: Schools Case Studies

Pensions and health care benefits for school employees are a vital part of compensation packages. Pensions and other benefits depend on school employee classification and can vary greatly among school employees.

School employees are categorized into two main groups: certificated and classified. Certificated members are generally teachers, nurses, librarians, and managers with teaching certificates, while custodians, cafeteria workers, bus drivers, teacher's aides, and non-certificated management generally fall under the title of classified.

Pensions vary depending upon whether an employee is certificated or classified but are uniform across school employers. Since the pensions of classified and certificated employees are standardized statewide, they will be described in this introductory section, rather than in each school district case study.

In comparison, other post-employment benefits (OPEB), including retiree health care, not only vary between these two groups but also from one school district to another. Retiree health care benefits are determined on a district-by-district basis and may also vary within a district for each employee classification. Generally, health care benefits are based on three main classification categories: certificated, classified, and management.

School Employee Pensions

Pensions for certificated employees are managed by the California State Teachers' Retirement System (CalSTRS), while pensions for classified employees

are managed by the California Public Employees' Retirement System (CalPERS). In addition to pension benefits, school employers may contract with CalSTRS or CalPERS to provide an additional tax deferred retirement savings vehicle for member contributions.

California State Teachers' Retirement System (CalSTRS)

The California State Teachers' Retirement System (CalSTRS) was created in 1913 to provide retirement benefits to California's public school educators. CalSTRS administers one main plan, the State Teachers' Retirement Plan (STRP) and three additional programs, the Voluntary Investment Program (VIP), the Teachers' Replacement Benefit Program (TRBP), and the Medicare Premium Payment Program (MPP). The STRP and supplemental programs are financed by four fiduciary funds: the Teachers' Retirement Fund (TRF), the Voluntary Investment Program (VIP), the Teachers' Health Benefits Fund (THBF), and the Teachers' Replacement Benefits Program Fund (TRBPF).¹

State Teachers' Retirement Plan (STRP)

The State Teachers' Retirement Plan (STRP) is a defined benefit pension plan which provides retirement, disability, and survivor benefits for certificated school employees. It is comprised of the defined benefit program (DB), the defined benefit supplement program (DBS), and the cash balance benefit program (CB). These programs are all administered by the 12 member Teachers' Retirement Board, which is made up of elected, appointed, and ex officio members.²

Defined Benefit (DB) Program

Background The defined benefit program is the standard pension benefit for all full-time school employees covered by CalSTRS.

Membership As of June 30, 2006, the defined benefit program had over 1,350 contributing employers (school districts, community college districts, county offices of education, and regional occupational programs).³ Defined benefit program membership consisted of the following:

Active Members	453,365
Inactive Members	133,601
Retirees and Benefit Recipients	207,846
Total	794,812⁴

Contributions Currently, school employers are required to contribute 8.25% of payroll to the fund, and school employees are required to contribute 8% of their salary to the fund.⁵

The State of California contributes 2.017% of total credible compensation per fiscal year, which includes salary and allowances, but not benefits such as health care. In addition, the State pays up to 1.505% of credible compensation if there is an unfunded obligation or normal cost deficit for the benefit design in effect on July 1, 1990.⁶ The benefit design of 1990 has been overfunded for a number of years, requiring that the State make only the 2.017% contribution to the DB Plan. As of the 2006 actuarial evaluation, the defined plan was 87% funded with an unfunded liability of \$19.6 billion.⁷

Normal Retirement Age and Vesting Normal retirement age is 60, with five years of service credited under the defined benefit program required to vest.

Formula All certificated school employees in California have the same retirement formula. The CalSTRS retirement formula is 2% of final compensation for each year of credited service at age 60, referred to as the “2% at 60” formula. This formula increases to 2.4% at age 63 in order to reward longevity in the classroom. In addition, members with 30 or more years of credited service receive an additional 0.2% of final compensation per year of credited service (beyond 30 years) added to

their benefit, with a maximum supplemental benefit of 2.4% of final compensation. In addition, members with at least 30 years of service by January 1, 2011 will receive an additional \$200 to \$400 per month, depending on the amount of service at retirement.

For purposes of determining final compensation for use in the benefit formula, final compensation is generally the highest average annual compensation earned for any 12 consecutive months for those with 25 or more years of credited service. For those with less than 25 years of credited service, final compensation is determined by the highest average annual compensation for any three consecutive years.

Defined Benefit Supplement Program

Background The defined benefit supplement (DBS) program was created by CalSTRS as a means to increase the retiree pension allowance. It was created with CalSTRS surplus funds during the early 2000s.

Members of this program have nominal accounts, meaning that members do not actually have property rights to their accounts like they would with a 401(k). Instead, they have the right to a benefit measured by contributions and interest credited to their accounts.

The DBS program credits a minimum guaranteed annual rate of return to members’ nominal accounts. The rate is established by the board prior to each plan year (5% in fiscal year 2005/06).⁸ Additional earnings may also be credited to members’ nominal accounts if actual earnings of the fund exceed the expected rate of return. Such a credit was awarded by the Board for 2005/06.

Membership All active members of the defined benefit program on or after January 1, 2001 are automatically part of the DBS program.

Contributions Currently, one quarter of each member’s 8% contribution to CalSTRS is credited to the member’s DBS account, with the other 6% credited to the defined benefit program. Beginning in 2011, the 2% member contribution to the DBS program will end, and the entire member contribution will again be credited to the DB program. Only the member and employer contributions to the DBS plan from excess service and special compensation will continue.⁹ As of the June 30, 2006 actuarial evaluation, the DBS program

was 112% funded and had an actuarial surplus of \$423 million.¹⁰

Cash Balance Benefit Program

Background The cash balance (CB) program is a hybrid defined benefit plan that has some of the features of a defined contribution plan (DC). It is designed for public school employees who are paid hourly, are part-time, or are trustees of a governing body of a school district or community college district. This would include substitute teachers working less than half-time. As of June 30, 2006, 30 school districts and 24,679 participants contributed to the CB Plan.¹¹

A guaranteed rate of return is adopted each year by the CalSTRS board based on various economic factors. Employees enrolled in a CB plan have a guaranteed rate of return of 5.25% for fiscal year 2007/08. Additional earnings may also be credited to members' nominal accounts if actual earnings exceed the expected rate of return. Such a credit was awarded by the Board for 2005/06.

While each member maintains a personal account balance, the plan sponsor is responsible for investment decisions. And because of the guaranteed rate of return, investment risk is borne by the plan sponsor, not the participant.

Contributions Employers and participants pay a total of at least 8-% of earnings, with the employer contributing at least 4%.¹² The minimum contribution rates for the CB program are set by statute, while the specific contribution rates are determined through the local bargaining process. As of the June 30, 2006 actuarial evaluation, the CB program was 111% funded and had an actuarial surplus of \$66 million.¹³

Social Security, Medicare, and the Medicare Premium Payment Program (MPPP) for CalSTRS Members

Social Security Benefits and CalSTRS Members

Prior to 1954, state and local governmental agencies were not allowed to provide Social Security coverage for their employees. Although local government agencies could choose to provide Social Security coverage after that date, it was not until 1961 that

the State of California elected to provide coverage for its employees. In 1955, the California Teachers' Association called for an every-member vote to determine whether all current and future teachers would be covered by Social Security. The teachers rejected the option to join Social Security by a 4 to 1 vote. This decision leaves all teachers outside of the Social Security system. All active teachers are exempt from Social Security tax; and all retired teachers live on their CalSTRS pensions without a Social Security benefit from their school employment.

In addition, any Social Security payments which may be earned from a second job or a spouse's employment may be reduced due to the Windfall Elimination Provision (WEP) and Government Pension Offset (GPO), which affect all who work for public employers that do not pay into the Social Security System. The WEP reduces Social Security benefits paid to many public employees who receive retirement benefits from employment not covered by Social Security if they also receive Social Security benefits from other employment they may have held. The GPO reduces spousal Social Security benefits paid to public employees who receive a government pension from service not covered by Social Security.

Medicare and CalSTRS Members

Medicare was created in 1965. Coverage was automatically extended to governmental employees who were subject to Social Security coverage. In 1986, federal legislation was passed extending Medicare coverage to all governmental employees hired on or after April 20, 1986 who are not covered by Social Security. As of 2007, the Medicare payroll tax is 1.45% of the employee's salary and is matched by an equal employer contribution.

State legislation was enacted in 1989 which allows local school districts to hold an employee election to determine if Medicare coverage should be extended to employees hired prior to April 20, 1986. Those hired before that date are eligible for Medicare only if their school has participated in such an election and the individual voted in favor of joining Medicare. Currently, 881 school districts have elected to extend Medicare coverage to their senior teachers and administrators. However, as of 2007, approximately 80 California schools, 7% of schools in California, have not held this election. These schools employ 3.4%, or 15,575, of CalSTRS active members.

Despite the fact that not all school employees are

covered by Medicare, health benefits for school retirees are often discontinued by the school district when the retiree reaches age 65. As a result, those without Medicare are left without any group health care coverage during their retirement years. In order to soften this financial hardship, CalSTRS has put in place the Medicare Premium Payment Program described below.

Medicare Premium Payment Program

Background and Benefit Another program administered by STRS is the Medicare Premium Payment (MPP) program which pays Medicare Part A premiums for qualifying members. STRS members without Medicare credits can buy into Medicare by paying the full cost of those premiums. However, some members chose not to enroll in Medicare Part A and/or Part B when they first became eligible because of the cost. The MPP program will also reimburse Part A and Part B surcharges for those members who became eligible and incurred surcharges prior to the creation of the MPP program. Surcharges are the increase in premiums due to late enrollment. If a member were to now enroll in Medicare after age 65, the MPP program would not pay the surcharge.

Medicare Part A premiums were \$393 per month in 2006 and \$410 per month in 2007.

Membership CalSTRS members qualify for the MPP program if they:

- retired prior to January 1, 2001 and are receiving a monthly CalSTRS allowance;
- are not eligible for premium-free Medicare Part A (hospitalization); and
- have enrolled in both Medicare Parts A and B at age 65.¹⁴

As of June 30, 2006, 6,087 retirees participated in the MPP program, representing 2.9% of retired members in the defined benefit program.

Contributions The MPP program is funded, as needed, from the portion of the monthly employer DB program contribution that exceeds the amount needed to finance the liabilities of the plan, as based on annual or biannual actuarial valuations. (The employer contribution rates are fixed, regardless of plan funded status).¹⁵

In fiscal year 2005/06, employers contributed

\$29,602,000. Net investment returns totaled \$143,000, bringing total additions to \$29,745,000. Total deductions came to \$29,672,000. The net increase in additions equaled \$73,000. As of June 30, 2006, the net assets for the MPP program totaled \$2.7 million at the beginning of fiscal year 2006/07. They increased by 3% to \$2.8 million.

California Public Employees' Retirement System (CalPERS)

Pensions for classified school employees are managed by the California Public Employees' Retirement System (CalPERS). Please see the background section for the city, county, and special district case studies for general information regarding CalPERS. As of June 30, 2006, CalPERS had approximately 1.5 million members: 1,048,895 active and inactive members, and 448,271 benefits recipients.¹⁶ School active and inactive members totaled 394,911.¹⁷

All schools have one employer contribution rate for their classified employees as determined by an annual actuarial valuation. For fiscal year 2007/08, the school employer contribution rate is 9.306% of payroll. The CalPERS benefit formula for classified school employees is "2% at 55." Members are vested in that benefit after 5 years of service.

Social Security Benefits and Classified School Employees

In 1959, the California Legislature adopted a provision to provide public employees (including classified school employees, but not certificated) the option of being included in Social Security. Since its adoption, every new classified school employee was automatically included in Social Security provided that the school district employer has contracted into Social Security. As a result, some classified retirees live on their pensions alone, while others have Social Security to supplement their pension benefit.

Health Benefits and Other Post Employment Benefits (OPEB) for School Employees

As discussed earlier, pension benefits for school employees are standardized statewide and only differ between employee classifications. In comparison, health care benefits and OPEB benefits vary greatly among school districts, with no standard plan or method for providing those benefits. Each school district provides a unique benefits package to its

active and retired employees based on its individual location, budget, and spending priorities.

It is also not uncommon for a single school district to provide different benefits to certificated employees, classified employees, and management. There may also be differences between the benefits offered to active and retired employees within each classification.

Benefits In 2006, CalSTRS conducted an employer health benefits survey which found that all of the responding employers provided some mechanism for medical and dental insurance coverage for their active employees. Approximately 25% of school employers offered a cafeteria plan, and about 8% of employers offered some type of health savings account. Three hundred eighty six (386) employers responded to the survey, representing a 35% response rate. Of the 386 respondents, all but 13 employers provided vision care benefits.¹⁸

For certificated employees, the CalSTRS 2006 Survey showed that 19% of employers surveyed offered no employer-paid health care for any retiree. Eighty six percent (86%) of employers surveyed did not provide any sort of employer contribution for retiree health benefits once a retiree reaches the age of 65. While the CalSTRS survey only inquired about benefit coverage for certificated employees, it can be assumed that an equal or greater number of classified employees also do not receive an employer contribution towards retiree health benefits.

Method of Providing Health Care Contracting methods vary greatly. Some school districts use a broker or a consultant to contract with health care insurers, while others contract directly with health insurance providers. Some have chosen to become members of a joint powers agreement (JPA) or a health care trust to take advantage of economies of scale, to pool health status and utilization risk, and to reduce administration costs. Some contract with CalPERS for their health insurance (for additional information about the CalPERS health benefits program, see the description contained in the introduction to the city, county, and special district case studies).

Chart 1 shows the breakdown of how school districts contract for health care benefits.¹⁹

Employer / Employee Costs The 2006 CalSTRS survey of school employers asked schools to provide information on current health insurance costs. Table 1 presents average monthly employer/employee costs for HMO and PPO single plans and a plan with multiple levels of benefits or tiers.²⁰ Tiered plans are plans which allow the member to choose from two or more plans with different plan features, such as higher or lower deductibles or co-payments.

Based on the survey, in 2006, statewide payments from school districts for health and welfare benefits to retirees totaled \$394,983,357 for all certificated retirees and \$209,095,613 for all classified retirees.

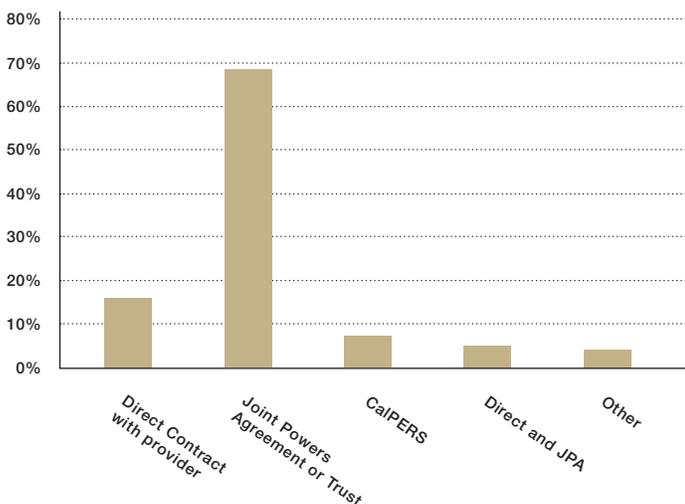


CHART 1:
School District Methods of Providing Health Benefits and OPEB

TABLE 1:
Average Monthly Employer and Employee Health Insurance Costs

	EMPLOYER COSTS	EMPLOYEE COSTS	% WITH NO EMPLOYEE COST
Single Employee PPO (single/tiered)	\$410	\$54	45%
Single Employee HMO (single/tiered)	\$356	\$24	87%
Employee Plus One PPO (single/tiered)	\$673	\$202	25%
Employee Plus One HMO (single/tiered)	\$619	\$154	30%
Employee Plus Family PPO (single/tiered)	\$905	\$300	17%
Employee Plus Family HMO (single/tiered)	\$796	\$154	24%
PPO Composite	\$850	\$147	43%
HMO Composite	\$733	\$70	54%

TABLE 2:
School District Case Study At-A-Glance Matrix

AGENCY	FUNDING METHOD	CERTIFICATED EMPLOYEES	CLASSIFIED EMPLOYEES	REVENUE	SOCIAL SECURITY FOR CLASSIFIED EMPLOYEES?	PROVIDES PENSIONS?	PROVIDES RETIREE HEALTH CARE?	ELEGIBILITY FOR RETIREE HEALTH CARE
Elk Grove Unified	VEBA sponsored by labor/mgmt	4,249	2,950	\$477.5 million	✓	✓	✓	15 years service (10 years service if hired prior to 7/1/06). Also, must retire from district and begin receiving retirement benefits at same time.
Encinitas Union	Revocable trust	292	193	\$42 million	✓	✓	✓	Up to 5 years of coverage for certificated employee with 15 years of service or classified employee with 14 years of services.
Los Angeles Community College District	Pay-as-you-go and irrevocable trust	7,500 (Total)		\$670 million	✓	✓	✓	Full-time classified and certificated employees with sufficient years to vest, currently 10, 15 and 20 years for new employees.

Section II

AGENCY	FUNDING METHOD	CERTIFICATED EMPLOYEES	CLASSIFIED EMPLOYEES	REVENUE	SOCIAL SECURITY FOR CLASSIFIED EMPLOYEES?	PROVIDES PENSIONS?	PROVIDES RETIREE HEALTH CARE?	ELEGIBILITY FOR RETIREE HEALTH CARE
Los Angeles Unified	Pay-as-you-go	35,646	36,490	\$6.5 Billion	✓	✓	✓	Based on date of hire, but generally between 5 to 15 years of consecutive service.
Modesto City Schools	Pay-as-you-go and union-sponsored trust	1,894	1,612	\$258 million	✓	✓	✓	Lifetime coverage for those retiring prior to 7/1/06. After 7/1/06, a union contribution may be available, based on eligibility criteria established by each union.
North Sacramento Elementary	Revocable trust	513	59	\$42 million	✓	✓	✓	Coverage up to the age of 65 for employees with 10 years of service who have obtained a specified retirement age.
Solana Beach	Pay-as-you-go and revocable trust	187	194	\$28 million	✓	✓	✓	Coverage up to 65 years of age. Eligibility and contribution varies by employee classification, age, and years of service.
Sacramento County Office of Education	Pay-as-you-go and irrevocable trust	185	402	\$158.5 million	No	✓	✓	Must be continuously enrolled as active employee in order to receive retiree health benefits. If hired after 11/1/06, employee also must agree to a payroll deduction of up to \$700 per year for at least 15 years.

- 1 California State Teachers' Retirement System, *Comprehensive Annual Financial Report, 2006* (Sacramento, CA: CalSTRS, 2006), pg. 14 http://www.calstrs.com/help/forms_publications/printed/CurrentCAFR/CAFRall.pdf.
- 2 The State Teachers' Retirement Plan Board of Directors is composed of twelve members including: the Superintendent of Public Instruction, the Controller, the Treasurer, the Director of Finance, three persons who are members of the system, and five local school district active governing board members appointed by the Governor for a term of four years, subject to confirmation by the Senate. <http://www.calstrs.com/About%20CalSTRS/Teachers%20Retirement%20Board/BoardPolicyManual.pdf>.
- 3 CalSTRS, *Comprehensive Annual Financial Report*, pg. 20
- 4 CalSTRS, *Comprehensive Annual Financial Report*, pg. 9
- 5 California State Teachers' Retirement System, *Overview of the California State Teachers' Retirement System and other Related Issues, 2007* (Sacramento, CA: CalSTRS, 2007), pg. 69 http://www.calstrs.com/Help/forms_publications/printed/Overview_2007.pdf.
- 6 CalSTRS, *Comprehensive Annual Financial Report*, pg. 67
- 7 Milliman Consultants and Actuaries, *California State Teachers' Retirement System Defined Benefit Program - 2006 Actuarial Valuation*, 2006 (Portland, OR: MC&A, 2006), pg. 4 http://www.calstrs.com/HELP/forms_publications/printed/2006_DB_Valuation_MillimanReport.pdf.
- 8 CalSTRS, *Comprehensive Annual Financial Report*, pg. 23
- 9 "Excess service and special compensation" refer to irregular labor performed by school employees such as overtime, summer school, after school activities, activities counseling, or other irregular teacher employment.
- 10 MC&A, *California State Teachers' Retirement System Defined Benefit Program - 2006 Actuarial Valuation*, pg. 5
- 11 CalSTRS, *Comprehensive Annual Financial Report*, pg. 24
- 12 CalSTRS, *Comprehensive Annual Financial Report*, pg. 23
- 13 MC&A, *California State Teachers' Retirement System Defined Benefit Program - 2006 Actuarial Valuation*, pg. 4
- 14 California State Teachers' Retirement System, *Medicare Premium Payment Program Eligibility & Processing Details*, <http://www.calstrs.com/Members/Medicare%20Premium%20Payment%20Program/mpppelig.aspx>.
- 15 CalSTRS, *Comprehensive Annual Financial Report*, pg. 24
- 16 California Public Employees' Retirement System, *Comprehensive Annual Financial Report, 2006* (Sacramento, CA: CalPERS, 2006), pg. 2 https://www.calpers.ca.gov/mss-publication/pdf/x2N8fznMvFGq5_CAFR2006.pdf.
- 17 CalPERS, *Comprehensive Annual Financial Report*, pg. 130
- 18 California State Teachers' Retirement System, *2006 Health Benefits Survey of Employers*, 2006 (Sacramento, CA: CalSTRS, 2006), pg. 4
- 19 CalSTRS, *2006 Health Benefits Survey of Employers*, pg. 5
- 20 CalSTRS, *2006 Health Benefits Survey of Employers*, pg. 7

Case Study Profile: Elk Grove Unified School District

Type of Agency:	School District
Number of Employees:	7,199 (4,249 Certificated; 2,950 Classified)
Number of Retirees:	902 (470 EGUSD, 432 EGBERT)
Revenue:	\$477,473,745 (2006/07)
Total Payroll:	\$381,010,008 (2006/07)
Has Held Medicare Election?	Yes
Classified Employees in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Accumulate 15 years of benefit-eligible service (10 years if hired prior to July 1, 2006). Also, retire from the District and begin receiving a retirement allowance from CalSTRS or CalPERS at the same time.

Background

The Elk Grove Unified School District (EGUSD) was established in 1959 and is located in Sacramento County. EGUSD is comprised of 62 schools educating 61,053 students, with 6,216 employees eligible for health benefits (5,314 active employees and 902 retirees). In fiscal year 2006/07, the District collected 17% of its General Fund revenue from property tax and 54% of its General Fund revenue from state aid. Of its total revenue, 76% was

unrestricted and the remaining 24% was restricted. The District's single largest General Fund expenditure was payroll, comprising 87% of total General Fund expenditures. EGUSD's General Fund received total revenue of \$7,821 per pupil and incurred expenses of \$7,315 per pupil. Thirteen percent (13%) of payroll was spent on active employees' health and welfare benefits in fiscal year 2006/07. For the same year, total District expenditures for retiree health

and welfare benefits were \$4.9 million, including \$2.3 million for EGUSD retirees and \$2.6 million for retirees participating in the Elk Grove Benefits Employee Retirement Trust (EGBERT). Employees who retired prior to July 1, 2000 are funded on a pay-as-you-go basis by the District; those who retired after July 1, 2000 are the responsibility of EGBERT.¹

Other Post-Employment Benefits (OPEB)

Benefits and Administration

EGUSD uses a combination of staff, an independent consultant, a broker, and a joint labor/management benefits committee to design health plan options and negotiate rates, enabling it to offer its active and retired employees medical, vision, and dental insurance. In the last 10 years, the District changed health plans an average of every three years to ensure ongoing competitive rates, with Kaiser Permanente and Health Net being the contracted plan providers for the 2007/08 benefit year.

Eligibility

Eligibility for OPEB benefits is the same for certificated, classified, and management employees. Employees become eligible for retiree health coverage when they have accumulated 15 years of benefit eligible service (10 years if hired prior to July 1, 2006). The employee must also retire from

the District and begin receiving retirement benefits from CalSTRS or CalPERS at the same time. OPEB benefits are not vested and are subject to available funds in a retiree benefit trust and/or annual negotiations with employee associations. In addition, retirees remain eligible for OPEB benefits beyond the age of 65.

Costs

In fiscal year 2007/08, EGUSD will pay 100% of dental and vision coverage for active employees and their dependents, as well as 100% of the lowest cost medical plan available to that participant. Through EGBERT, EGUSD provides the same contribution amount for retired employees (plus one dependent) for medical, dental, and vision coverage. If a participant chooses to enroll in a medical plan other than the lowest cost option or obtains coverage for additional dependents, the participant must pay the difference in cost.

Employees have no annual deductible and no copayments for hospital or outpatient surgery. There is a copayment of \$20 per physician office visit, \$20 for brand-name pharmaceuticals, \$10 for generic pharmaceuticals, and \$50 per emergency room visit. The lowest cost plan varies from year to year depending on rates negotiated with the health plan providers. Reviewing the health plans available since 1997, Kaiser was most frequently the lowest cost plan; from 1997/98 through 2002/03, Kaiser

was the lowest cost plan for all retirees. In the 2007/08 benefit year, Kaiser is the lowest cost plan for retirees not yet eligible for Medicare and Health Net is the lowest cost plan for Medicare-eligible retirees. EGUSD contracts separately for prescription drug benefits for those retirees not yet eligible for Medicare, an arrangement that is also known as a pharmacy carve-out.

Table 1 displays monthly premiums for the 2007/08 lowest cost health plan for coverage of a single individual. EGUSD pays the same benefit for certificated, classified, and management employees.

Funding Method

EGUSD funds part of its retiree health care benefits on a pay-as-you-go basis, while other retiree health care benefits are funded via EGBERT. EGBERT is governed by a joint labor/management board of directors. It has an administrative agreement with the District in which EGBERT pays the administrative fees to the district as a reimbursement for the staff time used in administering the trust—in 2006 that amount was \$46,000. Those employees who retired prior to July 1, 2000 are funded on a pay-as-you-go basis by the District; those who retired after July 1, 2000 are the responsibility of EGBERT.

EGBERT was set up as a 501(c)(9) non-profit trust and voluntary employee benefits association (VEBA) in 1995 in anticipation of rising health care costs. In order to ensure that health benefits could be provided on a long-term basis, the trust was established by the

Elk Grove Unified School District; the Elk Grove Education Association; the American Federation of State, County, and Municipal Employees; the Amalgamated Transit Union; the Psychologists and Social Workers Association; and subsequently, the California School Employees Association.

Between 1995 and 2000, the District made prefunding contributions to EGBERT totaling \$8,324,777, and no expenditures were paid out of the fund during that time. After July 1, 2000 the first expenditures were made from the trust, totaling \$14,453 for the first six months. From the inception of EGBERT through 2006, the District has made total contributions of \$36,584,658. Total expenditures for OPEB benefits during that same period were \$6,857,742. In 2006, contributions were \$7.9 million, while the OPEB benefits for 460 retirees required expenditures of \$2.66 million. In 2005, contributions totaled \$6.2 million, while the OPEB benefits for 369 retirees required expenditures of \$1.77 million. The fund's average annual rate of return was 9.01% in the first ten years of operation.

Chart 1 shows that the number of District retirees, whose benefits are covered on a pay-as-you-go basis, is declining and the number of retirees under EGBERT is increasing over time.²

The District's short-term target is to fund via EGBERT its "normal cost," of \$10,219,799, and its long-term target is to fund the "annual required contribution" of \$22,016,549, as determined in the 2006 actuarial report.

	ACTIVE EMPLOYEES	RETIRES NOT YET ELIGIBLE FOR MEDICARE	MEDICARE- ELIGIBLE RETIRES
Medical	\$336.99	\$403.48	\$198.00
Vision	\$6.69	\$7.13	\$7.13
Dental	\$60.69	\$66.85	\$66.85
Total	\$404.37	\$477.46	\$271.98

TABLE 1:
Monthly Health Plan Premiums

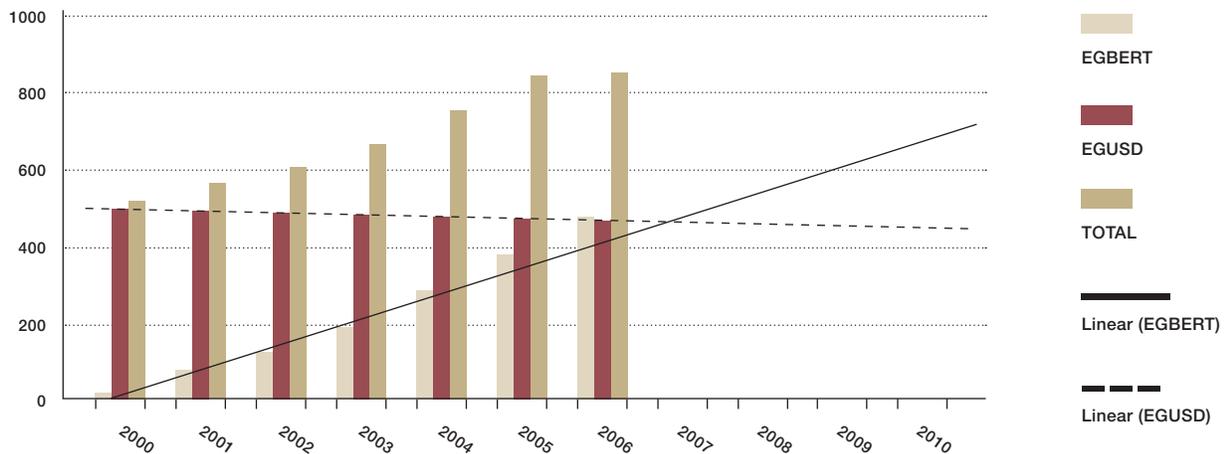
Although it came close, EGBERT was unable to meet its target of employer funding of 100% of the normal cost of the plan. Increases in health care costs, combined with higher health plan premiums resulting from separating retirees not yet eligible for Medicare from the active employee risk pool, created a normal cost beyond the amount the District had negotiated to fund. Negotiations are taking place for a possible additional lump sum contribution before the October 2007 actuarial report.

An actuarial cash flow analysis indicates that EGBERT is funded to meet its OPEB benefit obligations for another 15 years. If the annual

contributions do not increase and/or there is not a change in the benefit amount provided to retirees, the trust would exhaust all funds in year sixteen. The District and the employee associations have formed a Health Benefit Task Force and are continuing to explore possible changes to eligibility, plan design options, and contribution strategies.

The EGBERT board of directors continues to evaluate the investment targets on a regular basis and adjusts the asset allocation as needed. They also monitor the financial status of the trust and make funding or benefit change recommendations to the District management and labor leaders.

CHART 1:
Benefit Coverage—Transfer from Pay-As-You-Go to EGBERT



1 Elk Grove Unified School District, survey completed by district, September 7, 2007

2 Elk Grove Unified School District Retiree Health Benefits EGBERT, CalSTRS Health Benefit Task Force, March 16, 2007
http://www.calstrs.com/about%20calstrs/PEHBTF/Prsntn_RetireeMedicalBenefits.pdf

Case Study Profile: Encinitas Union School District

Type of Agency:	School District
Number of Employees:	485 (292 Certificated; 193 Classified)
Revenue:	\$42,138,361 (2005/06)
Total Payroll:	\$34,038,935 (2005/06)
Has Held Medicare Election?	No
Classified Employees in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes, for up to 5 years
Eligibility for Retiree Health Care:	For certificated employees, 15 years of employment; for classified employees, 14 years of employment.

Background

Encinitas Union School District (EUSD) in San Diego County was established in 1881. As of fiscal year 2005/06, EUSD had 9 schools with 5,647 students, and 451 employees covered by the district's health insurance (412 active employees and 39 retirees). During fiscal year 2005/06, the District received 65% of its revenue from property tax and 2% from state aid. Of its total revenue, 82% was unrestricted and the remaining 18% was restricted. The District's single largest expenditure was payroll (salaries plus benefits), comprising 83% of total expenditures. EUSD collected total revenue of \$7,627 per pupil and spent \$7,303 per pupil. The

District's expenditures for health and welfare benefits for active employees were 9.16% of payroll, while 0.5% of payroll was spent on OPEB benefits for retirees.¹

Other Post-Employment Benefits (OPEB)

Benefits and Administration

EUSD is a member of the Southern California Employer/Employee Trust (SCEET). SCEET is a trust comprised of 14 school districts. EUSD joined SCEET in 1989 in order to pool risk and to leverage

	ACTIVE EMPLOYEES	RETIREEES NOT YET ELIGIBLE FOR MEDICARE
Medical	\$329.03 (HMO)	\$380.13 (POS)
Vision	\$8.84 (HMO)	\$8.84 (HMO)
Dental	\$49.19 (PPO)	\$17.38 (PMI)
Total	\$387.06	\$406.35

TABLE 1:
2006 Monthly Health Plan Premiums

economies of scale. SCEET negotiates rates, benefit designs, and health plan options. Although it is difficult to estimate the savings from participation in the trust, as a school district with less than 500 employees, EUSD believes it has received better rates than it could have negotiated independently. Under the trust, each employer begins with the same base health plan rate. That rate is then adjusted by a health care claims experience factor, which results in customized insurance rates for each district.

EUSD offers medical, vision, and dental benefits to its active employees. The District also offers five years of health benefits to its retirees. Specifically, EUSD provides medical benefits and pays Medicare Part B premiums, if applicable, for retired certificated employees during the five years immediately following retirement. Depending on the certificated employee's age at retirement, District contributions can extend beyond age 65. EUSD provides similar medical benefits for retired classified employees for up to five years after retirement, but a classified

employee's coverage terminates once he or she reaches 65 years of age. If classified employees retire after age 65, they receive no health care benefit from the District.

Eligibility

Employee eligibility is determined by certificated and classified status and by duration of employment. Certificated employees become eligible after 15 years of employment, while classified employees become eligible after 14 years of employment. Classified employees who retire after obtaining age 65 receive no benefit.

Costs

Table 1 shows the 2006 monthly health plan premiums for an individual active employee or retiree.

Certificated, classified, and management employees receive the same employer contribution. For eligible active employees, the District contributes \$8,424

per year (2006/07) to a cafeteria plan from which an employee can pay for health insurance premiums. This \$702 monthly cafeteria plan contribution can be used to purchase dependent health coverage or other benefit options.

For retirees not yet eligible for Medicare, EUSD pays employer contributions of \$329.03 per month for HMO coverage or \$380.13 per month for POS coverage. The amount is based on whichever plan the employee was enrolled in immediately prior to retirement. For retirees eligible for Medicare, EUSD pays \$405.19 per month (\$4,862.28 per year), which includes Medicare Part B premium reimbursements. Because coverage of retired classified employees is only provided until 65 years of age, classified employees are not eligible for the contribution amount payable to Medicare-eligible retirees.

The District's total expenditures for OPEB benefits during the last three years are shown below. Based on data reported to the California Department of Education, *Table 2* shows expenditures for retired certificated employees and *Table 3* shows expenditures for retired classified employees.

According to the District, few classified employees work for the District long enough to qualify for benefits, or else the classified employees begin working for the District in their later years, preventing them from working long enough to qualify for retiree health benefits. In addition, retiree health benefits for a classified employee terminate at 65 years of age so the coverage period for a classified employee may be shorter overall depending on the employee's age at retirement.

On the other hand, retired certificated employees are eligible for health care benefits for up to 5 years, regardless of age or Medicare eligibility. Expenditures for certificated employees, as shown in *Table 2*, have steadily risen as certificated employees at EUSD retire in greater numbers.

Funding Method

EUSD has historically paid its health care costs on a pay-as-you-go basis, but recently began to partially prefund its unfunded liability. EUSD hopes to remove pay-as-you-go funding from its plan as early as next year. The District began prefunding its \$4.4 million unfunded liability as of the July 2007 payroll.

YEAR	2003/04	2004/05	2005/06
EXPENDITURE	\$62,819	\$73,283	\$117,808
PERCENT OF PAYROLL	0.20%	0.22%	0.35%

TABLE 2:
OPEB Benefit Expenditures for
Certificated Retirees

YEAR	2003/04	2004/05	2005/06
EXPENDITURE	\$38,930	\$28,447	\$42,450
PERCENT OF PAYROLL	0.12%	0.09%	0.12%

TABLE 3:
OPEB Benefit Expenditures for
Classified Retirees

Per actuarial recommendations, the District plans to contribute a total of \$299,000 during 2007/08. While the district has an annual unfunded liability of \$600,000, it is not currently feasible to fully prefund its liabilities, so EUSD plans to employ a partial prefunding mechanism.

In order to partially prefund, EUSD has incorporated the cost of partial prefunding in its annual budget. The prefunding contributions are deposited in a self-insurance fund established at the San Diego County Treasury. EUSD established the self-insurance fund (Fund 67) and, starting in 2007/08, all funding of the annual required contribution (ARC) is being deposited into this fund. As soon as adequate funding is available, the District will change from pay-as-you-go funding to annual funding of the ARC. Using a 30-year amortization of the unfunded accrued liability, the ARC is currently \$621,417. The funding of retiree health plan premiums will be charged directly to the self-insurance fund.

Two years ago, the District established a revocable fund, Fund 20, the Special Reserve Fund for Post-Employment Benefits under the accounting code structure provided in the *California School Accounting Manual*, in anticipation of retiree benefit costs being higher than budgeted. Fund 20 is a special reserve authorized under Education Code Sections 42840 through 42843, and is held in the county treasury. During the 2005/06 audit, the District's independent auditors recommended the District establish the fund and set aside money for OPEB benefits. The current balance in Fund 20 is \$526,985 which can be used for any unanticipated post-employment benefits.

EUSD plans to have an additional actuarial report performed in 2008 to determine the District's financial health. If the District has the ability to pay a greater amount towards prefunding, the annual contribution will increase above \$299,000. The District plans to move from their current partial prefunding to full prefunding as it becomes economically feasible.

¹ Education Data Partnership, Encinitas Union School District Profile 2005-06,
<http://www.ed-data.k12.ca.us/>

Case Study Profile: Los Angeles Unified School District

Type of Agency:	School District
Number of Employees:	72,136 (35,646 Certificated; 36,490 Classified)
Revenue:	\$6,472,010,648 (2005/06)
Total Payroll:	\$5,241,038,829 (2005/06)
Has Held Medicare Election?	Yes
Classified Employees in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes, Lifetime
Eligibility for Retiree Health Care:	Determined by date of hire and having worked at least the equivalent of 100 full-time days per year

Background

Serving most of Los Angeles County, the Los Angeles Unified School District (LAUSD) was established in the late 1960s when the Los Angeles City School District and the Los Angeles High School District merged. As of fiscal year 2005/06, it was comprised of 768 schools educating 727,319 students, with 104,605 employees covered by the District's health insurance (70,326 active employees and 34,279 retirees). For fiscal year 2005/06, the District collected 14% of its revenue from local sources, 71.8% of its revenue from state aid, and 13.5% of

its revenue from federal aid. Of its total revenue, 60% was unrestricted and the remaining 40% was restricted. The single largest expenditure the District incurred was payroll, comprising 82% of total expenditures. The District collected total revenue of \$9,465 per pupil and incurred expenses of \$9,204 per pupil. Nine percent (9%) of payroll was spent on health and welfare benefits for active employees. Four percent (4%) of payroll was spent on OPEB benefits for retirees.

MEDICAL	VISION	DENTAL
Kaiser; PacifiCare; Blue Cross HMO; Blue Cross HMO Plus; Blue Cross Preferred Plan, Out of Area; Medco Health; United Behavioral Health (UBH); UBH Employee Assistance Program	VSP Select Network; EyeMed Vision Care	Delta Preferred Option DPO/ OOA; DeltaCare PMI; United Concordia

TABLE 1:
Benefit Types and Providers

Other Post-Employment Benefits (OPEB)

Benefits and Administration

LAUSD contracts directly with health insurance providers for medical, dental, and vision coverage for active and retired employees. *Table 1* displays the various providers with whom LAUSD has contracted.

Eligibility

Eligibility for retiree health care is the same for certificated, classified, and management employees. As a result of collective bargaining, the employee's date of hire determines eligibility requirements. Further eligibility is determined by having worked the equivalent of 100 full-time days per year.

- Employees hired on or before March 11, 1984 must be eligible for District health coverage as an active employee for five consecutive years immediately preceding retirement.

- Employees hired after March 11, 1984, but before July 1, 1987, must be eligible for District health coverage as an active employee for at least ten consecutive years immediately preceding retirement.
- Employees hired on or after July 1, 1987, but before June 1, 1992, must be eligible for District health coverage as an active employee for at least 15 consecutive years immediately before retirement, or ten consecutive years immediately before retirement plus ten non-consecutive years.
- For employees hired on or after June 1, 1992, the sum of their age and the number of consecutive years of service immediately preceding retirement must equal 80 in order to qualify for retiree health care benefits (known as the "Rule of 80").

While eligibility requirements have become more stringent over time, the District has maintained a lifetime benefit. Efforts to control costs have focused on changing the eligibility standards, not the benefit amount.

Costs

Table 2 displays the cost of 2007 health plan premiums.

LAUSD pays a lifetime benefit of 100% of health, dental, and vision premiums for all active employees and retirees, plus eligible dependents.

The District's total expenditures for OPEB benefits during fiscal years 2003/04 through 2005/06 are shown below. *Table 3* shows expenditures for retired certificated employees and *Table 4* shows expenditures for retired classified employees.

Funding Method

LAUSD pays for OPEB on a pay-as-you-go basis. Although there are ongoing discussions, no current plans exist to begin prefunding. The current OPEB benefit unfunded liability for LAUSD is \$10 billion, as of 2005/06. An annual spending cap of \$816.3 million has been negotiated for total health expenditures during calendar year 2008, but no cap has been put in place solely with respect to retiree health benefits.

	ACTIVE EMPLOYEES	RETIREES NOT YET ELIGIBLE FOR MEDICARE	MEDICARE- ELIGIBLE RETIREES
Medical (Kaiser)	\$564.25	\$425.38	\$425.38
Vision (VSP)	\$7.76	\$7.76	\$7.76
Dental (United Concordia)	\$26.81	\$27.89	\$27.89
Total	\$598.82	\$461.03	\$461.03

TABLE 2:
2007 Monthly Health Plan
Premiums

YEAR	2003/04	2004/05	2005/06
EXPENDITURE	\$120,866,964	\$118,811,742	\$124,723,697
PERCENT OF PAYROLL	2.42%	2.34%	2.38%

TABLE 3:
OPEB Benefit Expenditures
for Certificated Retirees

YEAR	2003/04	2004/05	2005/06
EXPENDITURE	\$71,439,447	\$79,745,591	\$86,706,193
PERCENT OF PAYROLL	1.43%	1.57%	1.65%

TABLE 4:
OPEB Benefit Expenditures
for Classified Retirees

Public Employee
Post-Employment
Benefits Commission

Section II:
Los Angeles
Unified School
District

Case Study Profile: Modesto City Schools District

Type of Agency:	School District
Number of Employees:	3,507 (1,894 Certificated; 1,612 Classified)
Revenue:	\$257,775,121 (2005/06)
Total Payroll:	\$216,694,655 (2005/06)
Has Held Medicare Election?	Yes
Classified Employees in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes, those who retired prior to July 1, 2006 are eligible to purchase health coverage with a district contribution of \$48
Eligibility for Retiree Health Care:	Retire from the District with health care, prior to July 1, 2006

Background

Modesto City School District (MCSD) was established in 1871 and is located in Stanislaus County. MCSD is a common administration district composed of a high school district and an elementary district under one administration. Financial data for MCSD is filed as one entity, while student and staff information is reported separately for the two underlying districts. As of fiscal year 2005/06, Modesto City Elementary District was comprised of 27 schools with 17,345 students, and 1,943 employees (1,092 certificated and 851 classified). Modesto City High School District had 6 schools with 15,967 students, and 3,507 employees (1,894 certificated and 1,612 classified).

Of those combined 5,450 employees, MCSD has 2,669 employees (1,906 active employees and 763 retirees) eligible for health benefits. During fiscal year 2005/06, the District collected 68.62% of its revenue from local revenue sources including property tax, 10.39% from federal sources, and 17.37% from state sources. Of its total revenue, 72% was unrestricted and the remaining 28% was restricted. The District's single largest expenditure was payroll, comprising 86% of total expenditures. The District collected total revenue of \$8,189 per pupil and incurred expenses of \$7,873 per pupil. No expenditures were made toward health and welfare benefits for active or retired employees.¹

	ACTIVE EMPLOYEES	RETIREES NOT YET ELIGIBLE FOR MEDICARE	MEDICARE- ELIGIBLE RETIREES
Medical (Kaiser HMO)	\$352.14	\$502.14	\$318.38
Vision	\$18.89	\$19.57	\$19.57
Dental	\$48.10	\$48.10	\$48.10
Total	\$419.13	\$569.81	\$386.05

TABLE 1:
2007 Monthly Health Plan
Premiums

Other Post Employment Benefits (OPEB)

Benefits and Administration

Through a broker, MCSD contracts with health insurers to provide medical, vision, and dental benefits for active employees. The District allows retirees to purchase medical and dental coverage at a group rates for as long as they wish to keep it. Vision benefits are only offered for the duration required by COBRA. The plans available to active members and to retirees under the age of 65 are PacifiCare HMO, PacifiCare PPO, PacifiCare Catastrophic, and Kaiser HMO. For Medicare-eligible retirees, MCSD offers: PacifiCare Secure Horizons, PacifiCare Senior Supplement, and Kaiser Senior Advantage.

Eligibility

Benefits are not vested and are, therefore, subject to change. In order to qualify for retiree health care benefits, those who retired prior to July 1, 2006 had to have been enrolled in the District health care plan as an active employee at the time of retirement.

Costs

Table 1 shows an example of 2007 monthly health plan premiums for a single individual.

Employer contributions for active classified employees:

Full-time active classified employees receive \$419.78 per month for health plan premiums regardless of the employee's date of hire. Active classified employees working part-time (between 4 and 5.99 hours per day) receive contributions that vary based on the date of hire; if hired prior to May 19, 1998, the monthly employer contribution is \$365.21, and if hired on or after May 19, 1998, the monthly employer contribution is \$281.25.

Employer contributions for active management and certificated employees:

In 2001/02, active certificated and management employees negotiated for the employer to provide a salary increase in lieu of any employer contributions for active employee health care benefits. At the time, the negotiated salary increase added \$4,680 to the

employee's pay, and an employee can choose whether to purchase health coverage by paying 100% of the health plan premium.

Employer contributions for all retirees who retired prior to July 1, 2006:

District contribution for retiree health care varies based on retirement date. For employees who retired prior to July 1, 2006, the District provides an employer contribution of \$48 per month. Employees who retire on or after July 1, 2006 receive no employer contribution for health coverage. In 2006, the District decided to discontinue the \$48 monthly employer contribution due to concerns surrounding GASB 45. The following tables show the District's expenditures for those who retired prior to July 1, 2006. Based on data reported to the California Department of Education, *Table 2* shows expenditures for retired certificated employees and *Table 3* shows expenditures for retired classified employees.

Union contributions for all retirees who retired on or after July 1, 2006:

Union retiree health care contributions are derived from District funds provided to the unions. The unions then invest these funds and distribute them according to each group's determined level of payment, a decision made independently of the

district. The following are eligibility criteria and the contributions available through the unions:

- *Classified Retirees*

During the 1995/96 negotiations, the local chapter of the California School Employees Association and the District agreed to create a retiree medical benefit fund for employees only, with no provision for dependents. The District initially funded the plan with an \$85,000 contribution, and the District continues to make annual contributions of that amount. A joint union/management committee oversees the plan, reviews applications of classified employees wishing to obtain benefits, and initiates actuarial studies every three years to gauge solvency.

The "Rule of 80" establishes part of the criteria for retirees to receive the union contribution. Under the Rule of 80, an employee becomes eligible for a benefit when her age and years and service add up to 80. Additionally, employees must be enrolled in a District health plan at the time of retirement. Currently 28 retirees participate in the benefit plan. The benefit is prorated allowing a part-time employee working at least two hours per day to obtain access to health coverage with a monthly contribution (currently at 25% of the maximum). Prior to January 1, 2007, the maximum retiree contribution from

YEAR	2003/04	2004/05	2005/06
EXPENDITURE	\$588,831	\$649,613	\$727,822
PERCENT OF PAYROLL	0.29%	0.31%	0.34%

TABLE 2:
Certificated Retirees Health Care

YEAR	2003/04	2004/05	2005/06
EXPENDITURE	\$54,357	\$76,685	\$109,428
PERCENT OF PAYROLL	0.03%	0.04%	0.05%

TABLE 3:
Classified Retirees Health Care

this fund was \$200 per month. The local chapter membership voted to increase the maximum amount in September 2006 to the current maximum of \$300 per month. The benefit ceases to be available when the retiree reaches age 65.

The latest actuarial study conducted in October 2006 projects that the plan will remain solvent until 2025 at the current level of funding, assuming the following: an annual increase in the number of retirees of no more than five per year; the current level of increase in the cost of benefits remaining at 5%; and the continuation of a 3% interest earnings rate (which has been maintained since the inception of the fund).

- *Certificated Retirees*

As a result of negotiations in the 1980s, the District contributes \$112,000 annually to the Modesto Teachers' Association for retiree health benefits. Certificated retirees have a similar plan to that of the classified employees' plan. Specifically, certificated retirees who have worked 15 years for the District qualify to receive up to \$340 per month until the age of 68.

- *Management Retirees*

Management retirees receive up to \$364 after attaining age 55 and 10 years of service. Contributions are payable until the retiree reaches the age of 68, or the age of 65 if electing Medicare. This contribution amount changes annually and is based on the lowest health plan premium for that year. Management retirees obtain benefits through the classified or certificated union plans, as appropriate.

Funding Method

The District is using the pay-as-you-go approach to fund the employer contributions for those who retired prior to July 1, 2006. Although MCSD currently has an unfunded retiree health care obligation, the District expects the obligation to decline as the number of retirees receiving this benefit decreases through attrition. As a result, the district's OPEB liability is not open-ended. With respect to those who retire on or after July 1, 2006, the District considers its annual contribution to the unions a collective bargaining settlement, not an OPEB liability, leaving the District with no OPEB obligation for those benefits.

¹ An arrangement was made via collective bargaining between the district and the union which resulted in no direct district expenditures.

Case Study Profile: North Sacramento Elementary School District

Type of Agency:	School District
Number of Employees:	572 (513 Active Employees; 59 Retired Employees)
Revenue:	\$42,313,226 (2005/06)
Total Payroll:	\$30,962,370 (2005/06)
Has Held Medicare Election?	Yes
Classified Employees in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes, until age 65
Eligibility for Retiree Health Care:	Based upon years of service and employee classification

Background

North Sacramento Elementary School District (NSSD) was established in 1914 and is located in Sacramento County. As of fiscal year 2005/06, it was comprised of 11 schools educating 4,862 students, with 427 employees eligible for health care (244 certificated and 183 classified). For fiscal year 2005/06, the District received 13% of its revenue from property tax and 46% of its revenue from state aid. Of its total revenue, 66% was unrestricted and the remaining 34% was restricted. The District's single largest expenditure was payroll, comprising 87% of total expenditures. The District collected total revenue of \$8,873 per pupil and incurred

expenses of \$8,594 per pupil. Eight percent (8%) of payroll was paid toward health and welfare benefits for active employees, while 1.1% of payroll was spent on health and welfare benefits for retirees.¹

Other Post-Employment Benefits (OPEB)

Benefits and Administration

Through a broker, NSSD contracts with Kaiser, Health Net, Delta Dental, and VSP to provide medical, vision, and dental coverage for its active and retired employees.

	ACTIVE EMPLOYEES	RETIREES NOT YET ELIGIBLE FOR MEDICARE	MEDICARE- ELIGIBLE RETIREES
Medical	\$381.11	\$381.11	\$224.18
Vision	\$11.71	\$11.71	\$11.71
Dental	\$96.37	\$96.37	\$96.37
Total	\$489.19	\$489.19	\$332.26

TABLE 1:
2006 Monthly Health Plan
Premiums

The District provides an employer contribution for retirees under the age of 65, during which time they remain in the same risk pool as active employees. After age 65, retirees may enroll in a supplement to Medicare plan at their own expense. No employer contribution is provided once a retiree reaches 65 years of age.²

Eligibility

Employees become eligible for the employer contribution toward retiree health benefits based upon employee classification:

- For certificated employees, the employer contribution is earned after 10 years of service and reaching a minimum age of 55.
- For classified employees, the employer contribution is earned after 10 years of service and reaching a minimum age of 57.

Costs

Table 1 displays the 2006 monthly health plan premiums for an individual active or retired employee.

For active certificated employees, NSSD provides an employer contribution of \$400 per month (\$4,800 per year). The same employer contribution is provided to certificated retirees until the age of 65.

For active classified employees, the District provides an employer contribution of \$370 per month (\$4,440 per year), with the same amount provided to classified retirees until they reach the age of 65.

Management employees receive an employer contribution of \$512.50 per month (\$6,150 per year), with the same amount provided to management retirees until they reach the age of 65.³

Funding Method

In fiscal year 1995/96, NSSD began setting aside money in a revocable special reserve fund for post-employment benefits, also known as Fund 20 under the California School Accounting Manual's list of fund codes. Because it is a revocable fund, the money in the special reserve fund cannot be directly used to offset NSSD's OPEB benefit liabilities under Governmental Accounting Standards Board Statement 45 (GASB 45).

The District chose to utilize a revocable fund because it wanted more flexibility in the event of a possible reorganization with nearby school districts into a unified school district. Although flexibility is the goal, it would be difficult to transfer special reserve funds back to the District's General Fund since federal and state money (restricted funds) earmarked for OPEB benefits have been deposited in the special fund.

Contributions to the OPEB fund resemble an employer contribution to a pension system where payroll is used as a guide. The District applies the first part of the employer contribution, 1.1% of payroll, to all salaries, in order to fund the unfunded actuarial accrued liability (UAAL) portion of the annual required contribution. The second part, 0.9% of payroll, is applied only to contracted salaries, in order to fund the normal cost portion of the annual required contribution. These numbers

were determined actuarially, leaving the total cost of prefunding OPEB at approximately 2% of payroll each year.

The special reserve fund for post-employment benefits is invested in the county treasury. The rate of return for fiscal year 2005/06 was between 4% and 5%, producing a fund balance of \$1.9 million as of June 30, 2006.⁴ According to the 2006/07 actuarial valuation, the District had a total unfunded liability of \$5,920,850.

Although the money is invested as one fund, there are actually three separate prefunding targets: one for certificated employees, one for classified employees and one for management employees. The annual prefunding targets for the certificated, classified, and management groups are \$430,000, \$130,000, and \$55,000, respectively, with the total annual required contribution of \$615,000 for the District.

1 Education Data Partnership, *North Sacramento Elementary District Profile 2005-06*, <http://www.ed-data.k12.ca.us/>

2 Only 6% of schools provide some sort of payment toward Medicare Part B. California State Teachers' Retirement System, *Ca/STRS 2006 Health Benefit Employer Survey*, http://www.calstrs.com/Newsroom/What's%20New/2006_Health_Benefits_Survey.pdf

3 No California Department of Education data available for Certificated and Classified Expenditures

4 Modified accrual accounting

Public Employee
Post-Employment
Benefits Commission

Section II:
North Sacramento
Elementary School
District

Case Study Profile: Solana Beach School District

Type of Agency:	School District
Number of Employees:	381 (187 Certificated; 194 Classified)
Revenue:	\$28,054,090 (2005/06)
Total Payroll:	\$21,626,331 (2005/06)
Has Held Medicare Election?	Yes
Classified Employees in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes, until age 65
Eligibility for Retiree Health Care:	Determined by employee classification (certificated, classified, management), age, and years of service.

Background

Solana Beach School District (SBSD) was established in 1925 and is located in San Diego County. As of fiscal year 2005/06, it was comprised of 6 schools with 2,682 students, and 262 employees were eligible for health care (242 active employees; 20 retirees). For fiscal year 2005/06, the District collected 78% of its revenue from property tax and 2.5% of its revenue from state aid. Of its total revenues, 87% was unrestricted and 13% was restricted. The single largest expenditure the District incurred was payroll, comprising 78% of total expenditures. The District collected \$10,456 per pupil in revenue and spent

\$9,428 per pupil. Ten percent (10%) of payroll was paid toward health and welfare benefits for personnel, while 0.6% of payroll was spent on health and welfare benefits for retirees.¹

Health Care

Administrator and Providers

SBSD is a member of the Southern California Schools Voluntary Employee Benefits Association (VEBA) and is also self-insured with Keenan

	ACTIVE EMPLOYEES	RETIREES NOT YET ELIGIBLE FOR MEDICARE
Medical (HMO)	\$432.32	\$360.27
Vision	\$16.36	\$8.89
Dental	\$55.58	\$55.58
Total	\$504.26	\$424.74

TABLE 1:
2007 Monthly Health Plan Premiums

Associates and Delta Dental. VEBA coverage includes health care, prescriptions, and vision care. Keenan & Associates represents the District for dental, life, and income protection benefits.

The Southern California Schools VEBA began operations in October 1993 with administration by one of the trust's founders, McGregor Van De Moere Inc. (MVI).² The VEBA is a cooperative labor-management trust program established to provide quality health care to education employees in a cost-effective manner. After 13 years of operation, and as of the end of the 2006 fiscal year, the Southern California Schools VEBA included 26 districts, one association, and one county office of education. At that time, it served 38,000 employees and 47,000 dependents, making its total participation 85,000 members, including retirees.³

The Southern California Schools VEBA is an insured welfare benefit plan under IRS Code Section 501(c)(9). Funds are held by the administrator in bank trust accounts. Money that is not required for

short-term distribution is either invested in a money market account at an investment company with an interest rate of 1.13% or in certificates of deposit with up to seven months maturities and interest rates between 0.8% and 1%.

SBSD reports that it joined the VEBA in 1996 in order to obtain the highest quality benefits at the lowest rates possible. The VEBA negotiates rates on behalf of the Solana Beach School District and enables the District to take advantage of economies of scale. If considered alone, the District's small size and individual claims experience would make it difficult to secure reasonable rates.

Benefits

Through the Southern California Schools VEBA, Solana Beach Elementary School District offers medical, vision, and dental insurance to its active employees and retirees through PacifiCare HMO, POS (point-of-service), Scripps Deductible HMO, Vision Service Plan (VSP), Delta Dental, and Delta Care PMI.

Eligibility

While the VEBA determines which employers are eligible to join the plan based on which participants will add positively to its risk pool, school districts determine coverage eligibility for their own employees. At Solana Beach School District, retiree benefits are vested according to different requirements for certificated, classified, and management employees.⁴ In all cases, retirees must not be eligible for health benefits through any other employer.

Certificated Retirees

Certificated employees must have 15 years of service and be at least 55 years of age. At the time of retirement, the certificated employee also must have been eligible for health benefits as an active employee.

Classified Retirees

Classified employees must have worked over 35 hours per week for 15 years and be at least 55 years of age. They must also have been covered by the District's health benefits for the previous 15 years and be retired under CalPERS. These criteria exclude part-time classified employees from receiving retiree health benefits.

Management Retirees

To receive the employer contribution payable to management employees, an individual must have been a full-time management employee in the District for eight consecutive years and be at least 55 years of age.

Costs

Table 1 shows the monthly premium costs during the 2007 benefit year for individual health care coverage.

Employer Contributions

Active Employees

For active employees, SBSB pays 100% of the health plan premium amount for individual coverage. Dependents may enroll in the plan at the employee's expense.

Retired Employees

The District only provides health coverage until the retiree reaches 65 years of age. The employer contribution amount depends on employee classification, as follows:

- **Certificated**

After 15 years of service, certificated retirees receive District contributions of 75% of the health plan premium for the retiree only. The District pays an additional contribution of 5% per year of service in excess of 15 years, with 100% of the premium paid after 20 years of service.

In addition to health plan benefits, eligible certificated retirees are provided with the District's HMO dental insurance plan for the retiree only. The retiree may elect to receive dental coverage under any other District dental plan offered to active employees by paying the difference in premium costs between the HMO plan and the plan that she selects.

- **Classified**

Eligible classified retirees receive a District contribution according to their age. At age 55, the District contributes 50% of the premium amount for an individual retiree (enrolled in any particular plan?). An additional 5% is paid in each subsequent year, until the retiree receives 100% at age 65, after which coverage is terminated.

- **Management**

Regardless of classification, all eligible management retirees receive a District contribution of 50% of the health plan premium for the retiree only. For each year of District service in excess of eight years, the District contributes an additional 5% for each year, up to 100% after 18 years of service.

The District's total expenditures for retiree health and welfare, as reported to the California Department of Education (CDE),⁵ over the last three years are shown in *Tables 2* and *3*.

In fiscal year 2004/05, SBSB negotiated increases in copayments due to double digit premium increases. Despite the 2004/05 increase in copayments, health care costs have continued to rise. Costs made a significant jump in 2006/07 (not shown above) following a 42% increase from the VEBA for employees who wished to continue coverage with the Scripps Clinic health plan. Scripps is a large provider of health care services in San Diego County, and SBSB estimates that 40% of its personnel were

enrolled in Scripps when this increase took place. SBSB has retained Scripps for one more year, but is presently deciding whether to maintain Scripps for 2008.

OPEB Funding

Solana Beach School District currently funds OPEB benefits on a pay-as-you-go basis. Fiscal year 2006/07 will be the last year in which it remains under the pay-as-you-go system. The District has already begun putting funds aside to cover future OPEB liabilities. The funds are held in a Special Reserve for Post-

Employment Benefits, Fund 20 under the accounting code structure provided in the California School Accounting Manual, which is a revocable trust. SBSB has also reserved funds in the current year budget for OPEB benefit prefunding. An actuarial study presented in November 2007 showed an unfunded liability of \$6.8 million for the District. The District has started to discuss the available prefunding options. While the extent of any prefunding remains to be determined, SBSB does not anticipate prefunding 100% of its OPEB liabilities at this time.

YEAR	2003/04	2004/05	2005/06
EXPENDITURE	\$37,996	\$66,289	\$87,199
PERCENT OF PAYROLL	0.20%	0.32%	0.40%

TABLE 2:
 OPEB Benefit Expenditures
 for Certificated Retirees

YEAR	2003/04	2004/05	2005/06
EXPENDITURE	\$35,623	\$30,765	\$38,502
PERCENT OF PAYROLL	0.19%	0.15%	0.18%

TABLE 3:
 OPEB Benefit Expenditures
 for Classified Retirees

1 Solana Beach School District spent 0.6% of payroll towards health and welfare benefits for retirees as there were only 22 people receiving retirement benefits during 2005/06.
 2 http://www.vebaonline.com/PDFs/2004_2005_annual_report.pdf page 2
 3 http://www.vebaonline.com/PDFs/joining_successful_partnership.pdf page 2
 4 http://www.vebaonline.com/PDFs/2004_2005_annual_report.pdf page 15
 5 EdData

Case Study Profile: Sacramento County Office of Education

Type of Agency:	County Office of Education
Number of Employees:	587 (185 Certificated; 402 Classified)
Revenues:	\$158,531,243 (2005/06)
Total Payroll:	\$61,869,663 (2005/06)
Has Held Medicare Election?	Yes
Classified Employees in Social Security?	No
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes, lifetime under certain conditions.
Eligibility:	Retire from SCOE enrolled in active employee health care and having paid into the retiree health care plan while still an active employee.

Background

The Sacramento County Office of Education (SCOE) is located in Sacramento County. As of fiscal year 2005/06, it oversaw 109 schools with 1087 students, and 705 employees were eligible for health care benefits (421 active employees and 284 retirees). For fiscal year 2005/06, the Office collected 30% of its revenue from property tax and state average daily attendance reimbursements. An additional 2% of revenue came from federal revenue, while 68% was generated by other state and local revenue. Of its total revenue, 18% was unrestricted and the remaining 82% was restricted. Payroll was 40% of total expenditures. Seven percent (7%) of payroll

was spent on health and welfare benefits, of which \$1,085,280 was spent on retiree OPEB benefits.

Health Care

Benefits

Contracting with CalPERS for health benefits, the Sacramento County Office of Education currently offers medical, vision, and dental benefits to its active and retired employees through Kaiser, Blue Shield, and Blue Cross. Medicare supplemental plans are also offered by CalPERS to individuals over 65 years of age.

	SINGLE	2-PARTY	FAMILY
Medical: Blue Shield CA	\$484.21	\$968.42	\$1258.95
Vision	\$10.44	\$27.33	\$27.33
Dental	\$66.05	\$134.81	\$196.61
Total	\$560.70	\$1130.56	\$1482.89
SCOE Benefit Allowance (Classified)	\$479.94	\$479.94	\$479.94
Employee's Out-of-Pocket Costs	\$80.76	\$650.62	\$1002.95

TABLE 1:
2007 Monthly Health Plan
Premiums

Costs

For active employees, SCOE pays a fixed benefit allowance. For employees hired after November 2006, the amount is applied directly toward the selected health benefit plan premiums. For those hired prior to November 2006, however, the benefit allowance is a supplemental addition to the employee's regular pay; in other words, if the allowance is not used to purchase health benefits, it's available to the employee as additional earnings. With the benefit allowance included in the employees' total compensation, all of the health plan premiums are paid by the employee.

The amount of the employer benefit allowance depends on whether the employee is certificated, classified, or management. For active certificated employees, the employer pays a benefit allowance

of \$588.45 per month (\$7,061.40 per year). Active classified employees receive an employer benefit allowance of \$479.94 per month (\$5,759.28 per year). And for active management employees, the employer pays a benefit allowance of \$477.45 per month (\$5,729.40 per year).

All retirees meeting the employer's benefit eligibility receive an employer contribution equal to the lowest cost health plan available in the Sacramento region through CalPERS for enrollment of a single individual.

Costs of Employee Benefits

Table 1 provides an example of costs for health care coverage based on 2007 health plan premiums for classified employees.

The most recent total expenditures reported by Sacramento County Office of Education to the California Department of Education (CDE) are for fiscal year 2003/04. Total expenditures for retiree health and welfare are shown in *Table 2*.

Eligibility

Active Employees Health, Dental, and Vision

All employees who work at least 20 hours per week and 1,020 hours per year are eligible to enroll in the SCOE health, dental, and vision plans anytime within 60 days from the date of hire. Part-time employees receive a prorated portion of the benefit allowance.

Retiree Health Benefits

Employees must retire from SCOE in order to be eligible for the employer contribution. Per CalPERS' requirements, an employee must retire from CalPERS or CalSTRS within 120 days of separation from employment in order to be eligible for enrollment in a CalPERS health plan. (Both retirement systems require a minimum age of 50 and 5 years of service to be eligible for retirement.) Individuals who separate from SCOE employment without retiring lose their eligibility for SCOE's employer contribution towards retiree health coverage. There are additional eligibility requirements based on an employee's date of hire, as explained in the following paragraphs.

- *Employees hired prior to 11/01/2006*
Active employees must enroll in a health plan offered by SCOE by January 1, 2009 in order to be eligible for the employer contribution toward retiree health benefits. After January 1, 2009, employees who drop coverage for any reason are permanently ineligible for the employer contribution for retiree health benefits.

- *Employees hired after 11/01/2006*
Employees hired after November 1, 2006 must enroll in a health plan offered by SCOE on or before their hire date in order to be eligible for the employer contribution toward retiree health benefits. Employees have the option of electing or waiving retiree health benefit coverage. New hires that elect retiree coverage are required to pay the actuarial identified percentage of the employee's salary. Active employees are currently paying 2% of the first \$35,000 of salary. Employees paying towards retiree health coverage also must remain employed at SCOE for a minimum of fifteen years in order to qualify for retiree health benefits. Those employees who separate from SCOE before reaching the required fifteen years will be eligible for a refund of their contribution. Active employees who drop coverage for any reason are permanently ineligible for retiree health benefit coverage.

SCOE's employer contribution can only be applied toward medical health coverage. Retirees may remain in the dental and vision plans provided by SCOE, but the retiree must pay the full premium amount.

Funding Method

Sacramento County Office of Education has a hybrid system of funding retiree health care. OPEB benefits are funded on a pay-as-you-go basis, but SCOE also plans to prefund its current unfunded liability within 30 years. An actuarial valuation for the 2005/06 fiscal year found that SCOE's unfunded liability is \$30 million. SCOE has set a target of prefunding that \$30 million over the next thirty years.

SCOE has opted to participate in a Section 115 trust, an irrevocable trust, administered by CalPERS.

	CERTIFICATED	CLASSIFIED
Year	2003/04	2003/04
Expenditure	\$783,085	\$743,896
Percent of Payroll	1.38%	1.31%

TABLE 2:
OPEB Benefit Expenditures for all Retirees

Existing employees agreed to a 3% percent reduction in salary (2% for 2006/07 and an additional 1% for 2007/08), and the employer will deposit the foregone salary into the trust. This represents a permanent 3% reduction in the SCOE salary schedule. In addition, new employees are required to contribute an additional 2% of salary towards the prefunding trust, in effect paying 5% to offset the unfunded liability. New employees also must opt into retiree health coverage upon hire in order to be eligible for lifetime health care. Upon hire employees are given the choice to “opt in” or “opt out” of retiree health care coverage if they do not wish to pay the 2% contribution, but may still obtain health coverage while actively employed. Once the employee “opts in” to retiree health care coverage the decision is irrevocable.

Case Study Profile: Los Angeles Community College District

Type of Agency:	Community College District
Number of Employees:	Approximately 7,500
Revenue:	\$669,591,063 (2006/07)
Total Payroll:	\$495,123,865 (2006/07)
Has Held Medicare Election?	Yes
Classified Employees in Social Security?	Yes
Provides Pensions?	Yes
Provides Retiree Health Care?	Yes
Eligibility for Retiree Health Care:	Full-time classified and certificated employees with sufficient years to vest, currently 10, 15 and 20 years for new employees.

Background

The Los Angeles Community College District (LACCD) became a separate district from Los Angeles Unified School District in 1969 and has grown to become the largest community college district in the world. Currently, its nine colleges, stretching over 250 square miles in the greater Los Angeles area, enroll over 100,000 students. Classes are taught by 1,500 full time faculty and 3,400 adjuncts. The instructional program is supported by 2,600 other employees: administrators, classified, and unclassified employees.

Other Post-Employment Benefits (OPEB)

Benefits and Administration

The Los Angeles Community College District, through its Joint Labor Management Benefits Committee (JLMBC), uses a combination of staff, a third-party call center, and a broker to design and negotiate the cost of the medical, dental, and vision plan offerings. The JLMBC regularly seeks outside bids to ensure the competitive pricing of its health plans and servicing vendors. Active employees and retirees participate in the same LACCD-provided health plans, creating an implied subsidy obligation for the District under GASB 45.

Eligibility

Once retired from the District and receiving a monthly retirement allowance from CalPERS or CalSTRS, an employee is eligible for an employer contribution toward retiree health coverage if the employee also meets the following eligibility criteria:

- For employees whose most recent uninterrupted District employment began before February 11, 1992, the employee must render paid service to the District in a “qualifying position” for three or more years immediately preceding retirement.
- For employees whose most recent uninterrupted District employment began after February 11, 1992 but before July 1, 1998, the employee must render paid service to the District in a “qualifying position” for seven or more years immediately preceding retirement. The District will pay 100% of the District’s contribution towards premiums.
- For employees whose most recent uninterrupted District employment began on or after July 1, 1998, the District will pay: 50% of the employer contribution for retiree health benefits for those retirees who render service in a “qualifying position” for at least ten years, but fewer than fifteen years; 75% of the employer contribution for retiree health coverage for those retirees who render service in a “qualifying position” for at least fifteen years, but fewer than twenty years; and 100% of the employer contribution for retiree health benefits for those retirees who rendered service in a “qualifying position” for at least twenty (20) years.

Dependents, including spouses, qualified domestic partners, and unmarried dependent children, may participate in the health benefits program under certain conditions. In addition, upon the death of the retiree, the surviving spouse or other eligible dependent may receive an ongoing employer contribution toward health benefit coverage.

Costs

According to the agreements with its six employee unions, the District will cover 100% of the cost of the medical, dental, and vision plan offerings for active and fully vested retired employees and their dependents. Coverage is the same for certificated, classified, and management employees.

The plan offerings include a Blue Shield PPO with a \$200 deductible and a \$10 office visit copayment, a Blue Shield HMO with no deductible and a \$5 office visit copayment, and a Kaiser HMO with no deductible and a \$5 office visit copayment. All retirees over the age of 65 have benefits coordinated with Medicare, and retirees over age 65 who enroll in Kaiser are placed in the Kaiser Senior Advantage program in which Medicare benefits are assigned directly to Kaiser. There are no retirees over the age of 65 in the Blue Shield HMO.

The District applied for and receives a federal Medicare Part D subsidy for the retirees in the Blue Shield plans. Kaiser automatically enrolls its Senior Advantage members in Medicare Part D and receives a subsidy directly from CMS.

Tables 1 through 3 below contain enrollment and health plan premium information for the three health plans available to active employees.

Table 4 shows the number of retirees over the age of 65 enrolled in each health plan option, as well as the total annual premium cost for that coverage.

Table 5 contains the total enrollment and premium costs for the dental and vision benefits offered to active employees, while Table 6 contains similar information with respect to retiree coverage.

Table 7 provides historical data for the total annual expenditure by the District for health, dental, and vision benefits for retired employees.

Funding Method

A GASB 45 actuarial valuation received by the District in the fall of 2005 showed the following outcomes:

Actuarial Present Value of
Future Benefits: \$721.2 million

	NUMBER OF EMPLOYEES ENROLLED	2007 COST RATE
Single	805	\$482.15
2-party	721	\$1,009.62
Family	833	\$1,441.98
Total Annual	2359	\$27,806,833

TABLE 1:
Blue Shield PPO-Active Employees

	NUMBER OF EMPLOYEES ENROLLED	2007 COST RATE
Single	69	\$244.29
2-party	43	\$510.10
Family	96	\$728.39
Total Annual	208	\$1,304,589

TABLE 2:
Blue Shield HMO-Active Em-
ployees

	NUMBER OF EMPLOYEES ENROLLED	2007 COST RATE
Single	402	\$316.84
2-party	261	\$662.20
Family	351	\$950.52
Total Annual	1,014	\$7,606,037

TABLE 3:
Kaiser-Active Employees

Actuarial Accrued Liability: \$623.2 million
Annual Required Contribution
(ARC) for year one: \$55.0 million

After careful consideration in conjunction with the employees' six unions, the District determined that pre-funding a portion of the liability in an irrevocable trust would make retiree health benefits more secure, lower the District's GASB liability, and enable the continued offering of retiree health benefits to new hires. All parties agreed that continuing to offer

retiree health care coverage was in the interests of both employees and management, since the availability of retiree health coverage helps the District to recruit and retain outstanding employees in the competitive Los Angeles job market.

Through labor agreements, the District has committed to an annual contribution towards prefunding the OPEB liability, beginning in 2006/07 with a contribution of 1.92% of the 2005/06 full-time employee payroll. (That sum equals

	NUMBER OF RETIREES	TOTAL ANNUAL PREMIUM
Blue Shield PPO	2,088	\$17,320,526
Kaiser Senior Advantage	868	\$3,392,433

TABLE 4:
Enrollment Data for Retirees Over the Age of 65

	NUMBER OF RETIREES	TOTAL ANNUAL PREMIUM
Blue Cross Dental	3,338	\$3,366,699
Vision Service Plan (VSP)	3,581	\$586,966

TABLE 5:
Dental and Vision Benefits for Active Employees

	NUMBER OF RETIREES	TOTAL ANNUAL PREMIUM
Blue Cross Dental	3,049	\$2,477,457
Vision Service Plan (VSP)	3,126	\$619,698

TABLE 6:
Dental and Vision Benefits for Retired Employees

	2006/07	2005/06	2004/05
Expenditure	\$24,224,553	\$23,559,062	\$22,584,634
% of Payroll	4.9%	5.2%	5.32%

TABLE 7:
Total Annual Cost of OPEB Benefits

approximately one-third of the state's 2006/07 salary cost of living adjustment). Our adjunct faculty, who are not eligible for retiree health coverage, received the full 5.92% cost of living adjustment as a salary increase in 2006/07, while full-time employees received 4%. The District will contribute 1.92% of the previous fiscal year's full-time employee payroll each year towards the prefunding program. The District also agreed to contribute to the prefunding account the amount it receives each year from the federal government for the Medicare Part D employer subsidy. An overwhelmingly percentage of District employees voted to approve this agreement.

Representatives of the employee unions and District management agreed that the CalPERS prefunding program was the first choice for establishing an OPEB benefit trust. However, until the Governor signed legislation (AB 554) in 2007, the District was not eligible to participate in the CalPERS prefunding program.

Since that legislation was signed, the District is proceeding with this funding option. The District agreed to "fast-track" an updated actuarial study, this time using the assumptions required by the CalPERS program. When the valuation is completed early next year, the District plans to move the OPEB funds set aside in a reserve account with the county treasurer to an irrevocable trust administered by CalPERS. The balance in the account as of July 31, 2007 is approximately \$11 million.

Public Employee
Post-Employment
Benefits Commission

Section II:
Los Angeles
Community
College District

Commission Recommendations

A Plan to Address Pension and OPEB Obligations

Preface: Public Employee Post-Employment Benefits in California

State and local governments in California employed approximately 2.2 million workers (about 15% of the state's workforce) in January 2007. Of these, approximately 22% are state employees and 78% work for counties, cities, school districts, and special districts. The majority of public employees in California, approximately 75%, are members of the California Public Employees' Retirement System (CalPERS) or the California State Teachers' Retirement System (CalSTRS).

Post-employment benefits for public employees generally fall into two categories. The first is pension benefits which provide continuing income to employees after they retire. The average public employee in California has a pension of \$1,881 per month, while the average state employee has a pension of \$2,205 per month.

The second category is broadly defined as "other post-employment benefits" or OPEB. OPEB benefits include health care as well as vision care, life insurance, and dental care. There is a wide range of employer contribution levels for OPEB benefits provided to public workers. Some public employers pay nothing for health care after retirement, and others pay for lifetime coverage for retirees after only 5 years of service. Of those public employers which offer OPEB benefits, many provide some level of coverage and employer contribution after 10 years of service.

About half of public employees in California do not participate in Social Security. As a result, many retirees live on their pensions without any supplement from Social Security. The single largest group of public employees who are not Social Security participants is public school teachers and administrators who are members of CalSTRS. Most public safety employees also do not participate in Social Security.

Public agencies provide benefits in order to attract and retain top quality employees. The Governor's Executive Order creating the Commission stated: "Promised pensions and health benefits are vitally important to state workers and their families, especially public safety officers who put their lives on the line everyday. And they are obligations that must—and will—be paid by government. We must seek ways to meet these obligations while not harming other government programs and taxpayers or handing invoices to future generations."

Throughout the course of our hearings, the Commission received testimony from numerous active and retired public employees. They testified about the commitment they made to a career in public service and the importance of their pension and retiree health care benefits once they retired. The rising cost of health care has particularly impacted local government retirees, some of whom have had

changes made to their health care benefits after they have retired. These increased costs, however, have also impacted government budgets. The Commission's recommendations have been developed to balance these two concerns.

It is within the context of the Governor's promise and the concerns we heard from the public that we present the following recommendations.

Group 1 Identify and Prefund Financial Obligations

Recommendation 1

Public agencies providing OPEB benefits should adopt prefunding as their policy. As a policy, prefunding OPEB benefits is just as important as prefunding pensions. The ultimate goal of a prefunding policy should be to achieve full funding.

Recommendation 2

Each public employer shall identify its OPEB liability, adopt a prefunding plan, and make it public. If a public employer does not establish a prefunding plan, it shall clearly identify an alternative approach for addressing its OPEB liabilities and make public its reason for not prefunding.

Recommendation 3

The State of California shall establish prefunding as both a policy and budget priority, develop and make public a prefunding plan, and begin prefunding its OPEB liabilities.

Rationale

The majority of public agencies in California do not currently prefund their OPEB liabilities. Instead, most rely on the pay-as-you-go approach to cover current year costs without consideration of accumulated liabilities or future costs. For many years, the cost of health care for active employees and retirees was a relatively small portion of an agency's annual expenditures, and the pay-as-you-go funding strategy created no fiscal hardship for the employer. In recent years, however, the dramatic increases in health care costs, along with the new reporting requirements of GASB, have focused attention on the costs of these benefits. As a result, many agencies have begun to reevaluate their current use of pay-as-you-go to fund OPEB benefits and are instead considering prefunding strategies.

Prefunding refers to the deposit of assets in advance of their actual need in order to cover accumulated and future costs. In this report, prefunding can mean to either fully or partially fund those future costs. Typically, prefunding is linked to the deposit of assets into an irrevocable

trust account with investment earnings increasing available funds over time. Prefunding provides several benefits:

- Addresses both accumulated and future costs;
- Prevents intergenerational cost shifts;
- Provides retiree benefits at a lower cost to taxpayers; and
- Provides protection for retirees. At the practical level, while prefunding does not constitute legal vesting, it increases the likelihood that promised OPEB benefits will be delivered by ensuring the money is there to fund them.

While financing through prefunding will initially cost the employer more than continuing pay-as-you-go, the employer's long-term total cost will be less than pay-as-you-go because prefunding enables the employer to fund benefits as they are earned and the resulting investment returns will help fund the benefits. For most agencies, the cross-over point comes 10 to 20 years after beginning to prefund. Each year of prefunding immediately reduces the long-term unfunded liability. Using California's public retirement systems as a model, the investment returns brought about by prefunding could eventually pay for up to 75% of the money spent on retiree health care benefits.

In the case of the State of California, the recent valuation done by Gabriel, Roeder, Smith and Company (GRS) shows that immediately beginning to fully prefund would reduce the State's total reported actuarial accrued OPEB liability from \$47.88 billion to \$31.28 billion. The GRS report shows that the State's current pay-as-you-go annual OPEB cost is \$1.36 billion. If the State were to begin full funding in the upcoming year, it would need to pay an additional \$1.23 billion, for a total annual contribution of \$2.59 billion. Thus, according to the GRS report, prefunding would reduce the total reported actuarial accrued liability by \$16 billion, and over the next 30 years, primarily due to investment returns on the prefunded assets, make funds available for other State priorities.

Alternatively, the GRS report also shows that if the State were to immediately begin to partially (50%) prefund that OPEB liability, it would reduce the State's total reported actuarial OPEB liability from \$47.88 billion to \$38.24 billion. This course of action would require the State to pay an additional \$0.62 billion in the upcoming fiscal year, for a total contribution of \$1.98 billion.

While GASB 45 does not require public agencies which provide OPEB benefits to begin prefunding, it does require that such agencies both determine their liability and disclose it. The Commission recognizes that its recommendations on prefunding cover a wide range of sponsoring agencies. Some of these agencies may determine that it is not financially practical in the short term to fully prefund OPEB liabilities. However, the Commission recommends that public agencies develop a long-term plan to prefund their liabilities and begin prefunding as soon as practical,

even if the contribution is less than the normal cost. It is not the intent of the Commission that its recommendations on prefunding be construed to require public agencies to begin prefunding in FY 2008/09.

Recommendation 4

Any employer considering the use of OPEB bonds should fully understand, and make public, the potential risks they bring. Such risks include: shifting costs to future generations, converting a future estimated OPEB liability into fixed indebtedness, and the uncertainty concerning continued federal cost sharing for debt service on such a bond.

Rationale

Some public employers have chosen to fund their accrued OPEB liability through the use of an OPEB bond. This usually occurs in conjunction with one of two actions: either the prospective termination of employer-paid OPEB benefits or the prefunding of OPEB benefits going forward, on either a full or partial basis.

There are several considerations with using this funding vehicle. OPEB bonds are essentially an arbitrage strategy for use when the employer believes that the return on invested funds will be greater than the cost of the debt. If this turns out not to be the case, then the employer has locked in higher costs for the life of the bond. In contrast to pension obligation bonds where the actuaries can predict various pension factors in order to develop an accurate unfunded liability, the future costs of health care are difficult to project and the liability used for an OPEB bond may be a point-in-time calculation with significant future volatility. In addition, while GASB 45 does not obligate an agency to prefund OPEB benefits, the use of an OPEB bond eliminates budgetary flexibility by obligating an agency to making regular debt service payments. Finally, an OPEB bond, like a pension obligation bond, shifts the accounting for an unfunded liability from the OPEB or pension fund to the general fund budget. Thus, it runs the risk of giving the appearance that an OPEB or pension fund liability has been funded when in fact only the method of accounting for it has been changed.

Group 2 Limit Contribution Volatility and Use Smoothing Methods Judiciously

Recommendation 5

Public retirement systems which consider contribution rate volatility to be a problem should consider the use of longer asset smoothing periods to lessen that volatility.

Recommendation 6

A retirement system which has adopted an asset smoothing method should resist efforts to alter that method for short-term gain, including, but not limited to, contribution rate reductions and benefit increases.

Rationale

Virtually all employer contribution rates for pension benefits are determined by actuaries and periodically adjusted. One notable exception is CalSTRS, whose contribution rates are established in statute.

Employers generally have two main interests with regard to their pension contributions: low contribution rates and stable contribution rates. The advantage of low contribution rates is obvious, while a stable contribution rate is important for the purposes of budgeting and planning for the ongoing costs of the agency.

Large swings in asset value (market volatility) can greatly affect the employer contribution rate in defined benefit retirement plans.

- When the investment market underperforms and does not meet the expected rate of return, the resulting shortfall increases the unfunded accrued liability, which increases the employer's contribution rate.
- If investment returns are above the expected rate of return, those extra earnings reduce the unfunded accrued liability, which reduces the employer's contribution rate.

To stabilize employer rates, actuarial methods have been developed to help "smooth" short-term variability in the market value of assets. The shorter the smoothing period, the quicker that gains and losses will be recognized, resulting in a more rapid increase or decrease in the employer contribution rate. The longer the smoothing period, the slower gains and losses will be recognized, resulting in a slower increase or decrease in the employer contribution.

There is no "best" smoothing period for all retirement systems. Many retirement systems have smoothing periods for investment losses/gains which are as short as three years. The most common period is five years, while CalPERS has adopted a 15 year smoothing period. Each system must decide what goals are most important to it and choose a smoothing period accordingly.

The idea behind having a uniform actuarial policy for dealing with investment gains and losses is to ensure that gains and losses are treated similarly, so that gains are not quickly recognized while losses are recognized over a longer period of time. Once a retirement system adopts a smoothing period, it should not alter it for short-term political reasons. Employers often want longer smoothing when investment returns do not meet the targeted level since it helps them defer losses and pay less into the fund during the short-term. When the market beats investment return targets, there is pressure for a shorter smoothing period in order to recognize asset gains sooner and reduce the employer contribution. In exchange for a benefit improvement or other advantage, employee representatives may also agree with a shorter smoothing period to reduce employer contributions. It is important that the smoothing period, once chosen, be treated uniformly.

Recommendation 7

Generally, employer contributions should not fall to zero. An employer should be permitted to have a full or partial contribution holiday only when its retirement plan is substantially overfunded. As used here, “substantially overfunded” means that the existing surplus is used to pay for all or part of the normal cost only after that surplus is amortized over a 30 year period, the longest amortization period allowed by GASB. In particular, employer contributions should fall to zero (“full contribution holiday”) only in the rare situation that the surplus is so great that it could be expected to fund a full 30 years of normal costs.

Recommendation 8

An employer whose pension account is overfunded and who has an OPEB liability should, as its first priority, use that surplus to address its OPEB liability. This should be done either by (1) transferring such surplus directly to OPEB funding in a manner which complies with federal and state law, or (2) using the budgetary savings from any contribution holiday (determined in accordance with Recommendation 7) to make additional contributions to OPEB funding.

Rationale

In general, the regular, ongoing cost of a pension plan is the annual current service cost, called the “normal cost”. As used here, a “contribution holiday” means a year or series of years in which, because the system has a surplus, an employer makes a contribution to the retirement system that is less than the normal cost. These can range from a “partial contribution holiday”, where contributions continue but at less than the full normal cost amount, to a “full contribution holiday”, where the employer makes no contribution to the retirement system. Such holidays do not reflect pension policy best practices, in that they do not recognize the true cost that is accruing for the pension benefits and are disruptive to the employer when they end.

In the late 1990s, investment returns rose significantly. Large surpluses were produced as a result of these unprecedented investment earnings, as well as some retirement systems implementation of actuarial policies of using short amortization periods for surpluses. Due to these actuarial practices, some public agencies were allowed to reduce their contributions or even stop paying them at all, sometimes for several years. When a significant market decline beginning in 2000 eliminated the surpluses, employers experienced a rapid shift in funding status – from being overfunded with a contribution holiday, to being underfunded with a resulting demand for immediate, large contributions.

In the case of the State of California, its CalPERS pension contribution rose sharply from \$156,722,747 in 2000/01 to \$2,212,518,481 in 2003/04. While some have argued that this jump in cost was due primarily to the adoption of more expensive benefits, it is more properly

explained as being due to the combined effects (listed in order of cost impact) of a dramatic drop in the value of CalPERS assets, the cost of those new benefits, and a partial employer contribution holiday. Faced with similar swings in their own contribution rates, local public employers statewide asked their retirement systems to develop a more stable approach for future employer contribution rates.

The Commission recommends that full employer “contribution holidays” should never be permitted except under the circumstances set out above in Recommendation 7. Under the GASB rules, a plan with a surplus should show some reduction of contributions below normal cost. The term “substantially overfunded”, as used above in Recommendation 7, is defined to mean that an existing surplus can be applied against the annual normal cost but only after that surplus is spread out over a 30 year period, the longest amortization period allowed by GASB. This is exactly the same as the “minimum contribution” policy adopted by CalPERS in early 2005.

As an example, suppose an agency has a normal cost of \$30 million. (To keep the numbers simple, the sample calculations will ignore interest.) If the agency has a surplus of \$90 million and amortizes its surplus over a three year period, it will have \$30 million “extra” dollars to apply against its normal cost this year and each of the next two years. This could result in a full contribution holiday with zero employer contributions for those three years. With a 30 year amortization period, the same surplus would only reduce the employer contribution by \$1 million this year. That would allow a small “partial contribution holiday,” reducing contributions from \$30 million to \$29 million for 30 years, rather than a full contribution holiday for only three years.

For those agencies which do become overfunded, and which provide OPEB benefits, the pension overfunding can be used to provide additional OPEB funding. First, in some circumstances, by adhering to federal and state guidelines, some of the funds in an overfunded pension account can be transferred to fund an OPEB account. A variation of this practice is used by some of the ‘37 Act retirement systems.

A second approach can also be used. Under Recommendation 7, surpluses are used sparingly to reduce contributions below the normal cost level (partial or full contribution holiday). In that case the employer can take the budget allocations that would usually have gone to fund the full normal cost of pension benefits and use them to make contributions to the OPEB account. In effect the employer still budgets the full pension normal cost, only now a portion is contributed to the OPEB account instead of the pension system.

Either of these approaches could serve as an intermittent source of funding for OPEB liabilities.

Group 3 Increase Transparency and Accountability

Recommendation 9

Legislation should be enacted directing the State Controller's Office to develop a simple and inexpensive procedure to regularly collect and report OPEB data from California public agencies. In order to minimize reporting requirements for public agencies, all the data collected for this report should be contained in the GASB 45 actuarial valuation report periodically required of each public agency and in the agency's GASB 45 footnote. Reporting should be mandatory for those agencies which provide OPEB benefits.

Recommendation 10

The State Controller's Office should publish the annual report of public pensions, which is required by current law, within 12 months of the receipt of data but in no case longer than 18 months after the end of the fiscal year.

Rationale

Public agencies have a responsibility to keep the public informed of their activities. Part of the governing process is to create accurate and timely reports on the business of governing. It is in the public's interest for public retirement systems and employers providing pension and OPEB benefits to report on the status and adequacy of funding for these benefits. However, current reporting mechanisms do not provide for the timely and accurate disclosure of pension and OPEB liabilities.

Under current law (Government Code Sections 7501 through 7504), each public retirement system is required to have an actuarial valuation performed at least once every three years. That actuarial valuation is used to evaluate the system's assumptions for reasonableness, compared to the actuary's estimate of anticipated experience. The system actuary is required to report any differences between the assumptions and techniques used by the system and those of the actuary, and to disclose the costs resulting from those differences. Both CalPERS and CalSTRS employ full-time actuaries to perform statutorily required valuations and prepare reports to the Legislature and the Governor on a variety of topics.

In addition, all public retirement systems are required to have annual financial audits and submit audited annual financial reports to the State Controller within six months of the close of their fiscal year. The State Controller is then required to compile and publish an annual report on the financial condition of all state and local public retirement systems. In some instances, publication of this information has been delayed for a significant period of time. The State Controller's report serves as a reference on the status and adequacy of funding for public retirement systems in California. Delays in reporting of data serve to degrade the usefulness of this report.

In comparison to current reporting requirements for pensions, California does not have a process to gather and publish OPEB data from public agencies. As public agencies and policy makers continue to address OPEB issues, it would be helpful to have a single entity to accept, compile, and report statewide OPEB-related data. The California State Association of Counties (CSAC), the League of California Cities, and several other associations requested that the Commission consider the idea of establishing a centralized OPEB reporting mechanism.

Many public agencies in California provide some form of access and/or employer contributions to retiree health care and must comply with GASB 45. As a part of GASB reporting requirements, these agencies will already be gathering information regarding their OPEB obligations and should have this data available to submit for a state-level report. Depending on their size, agencies will have to report their OPEB information every 2 or 3 years.

The best information, however, is only as useful as it is available, and it is the intent of the two above recommendations to make ongoing reporting of unfunded pension and OPEB liabilities available on a timely basis.

Recommendation 11

With the exception of school districts and county offices of education, legislation should be enacted to amend Government Code Section 7507 to provide for more clarity in its cost reporting requirements and for clear accountability within a public agency adopting new benefit levels. Specifically, where that section now calls for the determination of “future annual costs”, it should be clarified to include “normal cost and any additional accrued liability”. Concerning increased accountability, language should be added which requires that the person holding the position with the responsibilities of a chief executive officer within the affected agency acknowledge in writing the actuary’s cost determination for the new benefit. School districts and county offices of education shall comply with disclosure requirements pursuant to AB 1200 (Chapter 1213, Statutes of 1991) and AB 2756 (Chapter 52, Statutes of 2004).

Recommendation 12

With the exception of school districts and county offices of education, legislation should be enacted to amend Government Code Section 7507 so that it also applies to the granting or changing of OPEB benefits. As with pension benefits, this statutory change would require that the future costs of the proposed benefit change be determined by an actuary and be made public at least two weeks prior to adoption. School districts and county offices of education shall comply with disclosure requirements pursuant to AB 1200 (Chapter 1213, Statutes of 1991) and AB 2756 (Chapter 52, Statutes of 2004).

Recommendation 13

With the exception of school districts and county offices of education, legislation should be enacted to amend Government Code Section 7507 to require that pension and/or OPEB benefit changes be subject to the public notice requirements found in that section and be presented with an actuary available to answer any questions or to provide additional information, as needed. The presentation and report should be in language easily understood by the layperson, and such information should not be placed on the consent calendar. School districts and county offices of education shall comply with disclosure requirements pursuant to AB 1200 (Chapter 1213, Statutes of 1991) and AB 2756 (Chapter 52, Statutes of 2004).

Rationale

Pension or OPEB benefits are typically determined via collective bargaining agreements negotiated between the employer and representatives of the employees. When a tentative agreement is reached, it is generally brought before the governing body for ratification. The nature of this process often does not lend itself to public disclosure while negotiations are taking place. Generally, the public is only made aware of the nature of an agreement once it is presented to the governing body for approval. There is also a lack of consistency between the information an agency is required to make public before approving an improvement in retirement benefits compared to that required when it adopts or changes OPEB benefits.

Existing state law, Government Code Section 7507, requires public notice concerning the cost of proposed pension benefits and currently applies to “The Legislature and local legislative bodies.” Specifically, it requires that the adoption of pension benefits be reported by an actuary and be publicly noticed before adoption. However, some local agencies have placed the adoption of benefits and the related cost analysis on the consent calendar, where it is passed without discussion. There has also been concern that cost reporting requirements are not specific enough, as well as questions whether a governing body truly understood in all cases the cost of the adopted benefits. Retirement systems report that it is not uncommon for public agency representatives to complain some time after adopting a new benefit that they never understood the costs related to that decision.

Because the Education Code provides reporting requirements which are separate from, but comparable to, those found in Government Code Section 7507, the above three recommendations reference legislation in the Education Code as controlling for school districts rather than Section 7507.

Finally, another concern of the Commission is the fact that the existing “sunshine” provisions set out in state law for the adoption of pension benefits do not apply to changes in OPEB benefits. The proposed changes contained in the three preceding recommendations seek to remedy that situation.

Please see the Notes section at the end of the recommendations for additional details on existing disclosure requirements.

With the changes set out in Recommendations 11, 12, and 13, as shown in underline, Government Code Section 7507 could read as follows:

“7507. The Legislature and local legislative bodies shall secure the services of an enrolled actuary to provide a statement of the actuarial impact upon future annual costs, including normal cost and any additional accrued liability, before authorizing increases in public retirement plan benefits or in OPEB benefits. An “enrolled actuary” means an actuary enrolled under subtitle C of Title III of the federal Employee Retirement Income Security Act of 1974 and “future annual cost” shall include, but not be limited to, annual dollar increases or the total dollar increases involved when available as well as normal cost and any additional accrued liability. The future annual costs as determined by the actuary shall be made public at a public meeting at least two weeks prior to the adoption of any increases in public retirement plan or OPEB benefits. An actuary shall be present to provide information as needed at the public meeting where the adoption of the new benefit will be considered. The adoption of any benefit affected by this section shall not be placed on the consent calendar. Upon adoption of a new benefit, that person in the agency with the responsibilities of a chief executive officer shall acknowledge in writing that he or she understands the current and future cost of the benefit as determined by the actuary.”

Group 4 Improve Plan Design and Communication with Employees

Recommendation 14

An employer making a contribution to retiree health care should make that contribution proportionate to the number of years of employment and should reward longer careers. This recommendation should be implemented through collective bargaining and should be applied to newly hired employees. The use of proportionate credit to earn the employer contribution for retiree health care should apply only to service retirement.

Rationale

For purposes of this discussion, proportionate benefit design means that the longer an employee works, the more benefits she will earn. The methodology and funding of public pensions comply with the requirements of proportionate benefit design and encourage public employees to work longer. This is often not the case with retiree health care, where some public employers currently provide lifetime health care after as little as five years of service.

Retiree health care benefits offered by public agencies can play an important role in recruitment and retention of employees. As health care has become more expensive, it has become increasingly important for employers to establish a schedule of benefits for retiree health care that

rewards longer careers and encourages employee retention. As expanded upon below, there are two elements to this discussion: (1) access to the health care plan at the retiree's own expense, and (2) qualifying for the employer health care contribution, if any.

Access to the Health Care Plan

The importance of retiree access to the health care plan can especially be seen in the case of employees who do not work long enough to earn an employer contribution toward retiree health care. In addition, some employers choose to offer retirees access to contracted health plans, but with no employer contribution towards that coverage. For these individuals, access to the health care plan in retirement can be quite valuable. Access allows the retiree to buy health coverage at the group rate, which is often cheaper than coverage available as an individual, and under a group plan, carriers are not permitted to drop coverage due to adverse health conditions. In addition, retirees not yet eligible for Medicare may find that they are unable to secure health coverage in the individual market. Access to the group health plan may provide an important safety net for those individuals.

Generally, those employers which provide access do so through the use of a service credit threshold, meaning the retired employee is given access to the group plan after working a certain number of years with that employer. Such thresholds generally run from 1 to 10 years of service, with 5 years being the most common. Access to group coverage can be very valuable to retired public employees. Denying access or forcing retirees into a "retiree only" pool can be very harmful.

Employer Contribution

The second element relates to the retiree qualifying for all or part of an employer contribution toward health care in retirement. A retiree may be eligible for access to health care coverage, but whether the employer contributes towards the cost of that coverage is separately determined. In this latter case, an employer can structure eligibility criteria for the employer contribution to encourage employees to work longer or shorter periods.

An example of a low threshold for receiving the employer contribution for health care in retirement can be found with the California State University (CSU). CSU retirees are eligible for the maximum (100%) employer contribution to retiree health benefit premiums after having worked for only five years.

In contrast, two examples of increased eligibility requirements can be found with other employees of the State of California and with the County of Los Angeles:

1. State of California - Access to the employer's retiree health care plan after 5 years of service with the employee paying the full cost of coverage; 50% of the employer contribution after 10 years of service; and 100% of the employer contribution after 20 years of service, with the intervening years from 11 to 20 prorated at 5% per year.

2. Los Angeles County - Access to the employer's retiree health care plan upon retirement. Retirees with less than 10 years of service pay the full premium cost. Retirees with 10 years of service receive 40% of the employer contribution, and receive 100% of the employer contribution after 25 years of service, with prorated increases of 4% per year between 10 and 25 years.

The Commission recommends that if an employer provides payment toward retiree health care coverage, that payment should be structured to provide an incentive for longer careers.

Employees who are injured in the course of employment, most commonly safety members, may require specific rules regarding access to health plans and employer contributions toward premium costs. Recommendation 14 addresses employer contributions made on behalf of non-disabled retirees and is not intended to apply to those employees disabled in the course of employment.

Recommendation 15

An employer providing retiree health care should make that benefit dependent upon the employee retiring within a set time after separation from the job.

Rationale

If an employer offers retiree health care, it should take steps to more accurately calculate its retiree health care liability. The first step is determining how many people have earned the benefit. To facilitate that determination, an employer could require that an employee retire within a set period of time after terminating employment. Many agencies, including the State of California, require that an employee retire within 120 days of separation from the job in order to qualify for the retiree health care benefit, but an employer could decide on any length of time.

The City and County of San Francisco is an example of an agency which does not require this link between retirement and separation, although there are discussions underway to change that practice. In San Francisco, once an employee works for 5 years, regardless of separation date, she has earned lifetime retiree health care coverage with an employer contribution. Although the service may have been provided 30 or 40 years ago, and there may have been no communication with that former employee for decades, the former employee is still fully entitled to the benefit. Given this situation, it is nearly impossible for an agency to estimate how many people will eventually claim employer-paid retiree health care.

Recommendation 16

Public sector employers should provide tax-advantaged supplemental savings plans (e.g. 457, 401(k), 403(b), etc.) to their employees on an "opt out" basis. Public employers and their employees should jointly determine the details of any plan offered, including: whether to use a

“hard” or “soft” opt out, the minimum contribution amount, and any default investment selection for employee contributions. Employers should also develop an ongoing program to educate employees about their savings options.

Recommendation 17

Public employers should provide regular explanations to their employees concerning the advantages of their defined benefit (pension and OPEB) plans, the role of compounded interest in their personal savings programs, and the advantage of contributing to savings on a pre-tax basis. Employees who participate in Social Security should be educated that this is a supplemental program only and not a retirement plan. This information should be communicated at regular intervals throughout an employee’s career.

Rationale

An estimated 50% of California’s public sector employees do not currently participate in Social Security. Public school teachers and administrators who are members of CalSTRS are the single largest group of public employees without Social Security coverage. Most public safety employees also do not participate in Social Security.

Unless there is a federal mandate requiring all public employees to participate in Social Security, it seems unlikely that substantially more public employees will join that program. That is due to several reasons, two of the most important being:

- The relative expense of buying a Social Security benefit compared to buying it through a California defined benefit plan; and
- The fact that Medicare is often seen as perhaps the most valuable component of Social Security. Since 1986, all employees, whether in Social Security or not, must contribute to Medicare, thereby lessening the perceived value of joining Social Security.

In the United States, personal savings, for retirement and other purposes, has declined significantly in recent years. Years with a negative savings rate have even been reported. There is a great concern that Americans in general are not saving sufficiently to meet their financial needs for retirement. Part of the reason for this lack of savings is that many people have not been educated about the basics of saving, such as the value of pre-tax contributions and earnings, the effect of compounded interest, and the long-term effect of regular savings of even small amounts.

Although many employers offer supplemental savings plans for their employees on an “opt in” basis, there is often a relative low employee enrollment rate in these plans. In response to low participation levels, some employers have begun offering plans on an “opt out” basis, meaning that an employee is automatically enrolled upon hire but with the option to later disenroll. The goal of an opt out approach is to increase enrollment while helping employees to realize that investment and financial planning for retirement need be neither difficult nor expensive.

- A “soft” opt out supplemental savings plan requires the employee to simply fill out a disenrollment document and provide it to the employer if they choose not to participate in the supplemental savings plan.
- A “hard” opt out supplemental savings plan requires employees to fulfill additional requirements in order to stop participation in the plan. One possible plan design requires employees to demonstrate financial hardship in order to disenroll. Another approach requires employees to opt out of the plan within a specified amount of time.

Recommendation 18

Public employers should provide clear explanations to employees concerning current eligibility rules for retiree health care and the terms under which retiree health care is earned. Employers should also clearly explain to their employees the conditions under which health benefits for retirees are to be funded and paid. This information should be communicated at regular intervals throughout an employee’s career and through plan documents and collective bargaining agreements.

Recommendation 19

Public employers should provide timely notification to both active and retired employees when proposing a change in retiree health care benefits. This notification should be provided in a time frame that reasonably allows affected employees and retirees to understand the impact of the benefit change, to review other options available to them, and to comment to the employer on the proposed changes.

Rationale

The Commission has heard extensive testimony concerning situations where the process for earning health care in retirement was not understood by active or retired employees. It was apparent in much of this testimony that there were misunderstandings among many of the retirees concerning the level of employer contribution they had earned while working as active employees. This resulted in some retirees finding themselves without the health care benefit they had planned upon.

The Commission also heard troubling testimony about the experiences of retirees from local agencies where changes in benefits were made after the employees had retired. The Commission believes that local agencies should adopt a similar policy to that articulated by the Governor when he announced the creation of the Commission. Specifically, he said,

“Promised pensions and health benefits are vitally important to state workers and their families, especially public safety officers who put their lives on the line everyday. And they are obligations that must – and will – be paid by government.”

The Commission strongly encourages agencies to not make changes which will have a detrimental effect on their retirees.

Recommendation 20

CalPERS should periodically inform its contracting agencies about the option of allowing permanent part-time employees access to the PEMHCA health care system. The amount of the employer contribution, if any, should be collectively bargained.

Rationale

Eligibility for participation in PEMHCA health coverage is dependent upon an individual meeting the definition in PEMHCA law of an “employee” (Government Code 22772). This definition excludes individuals employed in intermittent, irregular, or less than half-time positions. However, legislation enacted in 2000 allows contracting agencies, including school employers, the option of extending health coverage to part-time employees who work less than half-time (Government Code 22807).

The contributions of part-time employees are valuable to many public agencies. Public agencies should evaluate the option of offering health care to part-time employees as a mechanism to enhance recruitment and retention of this category of employees.

Recommendation 21

Public employers should evaluate participation in alternate arrangements, including joint power authorities (JPA) and regional health care risk pools, as a means of providing retirees with access to health care coverage.

Rationale

As discussed above, the Commission heard testimony concerning situations where changes were made in benefits after the employees of local agencies had retired. In some instances, retirees were placed into a separate, higher cost risk pool or forced to purchase health care in the individual market. Concerns have been raised that some retirees may not be able to afford the higher premium costs resulting from these changes. In light of this testimony, the Commission encourages public employers to meet their existing commitments to retirees and also explore alternative options to providing retirees with access to health care.

Group 5 Provide Independent Analysis

Recommendation 22

Legislation should be enacted to create a California actuarial advisory panel at the state level. The purpose of the advisory panel would be to provide the California Legislature, the Governor’s office, public retirement systems, public agencies, and other interested parties with impartial and independent information on pensions, OPEB benefits, and best practices.

Such a panel would encourage greater transparency and understanding of actuarial methodology and assumptions used by public retirement systems and would gather and provide information concerning best actuarial practices. Individuals appointed to the advisory panel should have the requisite technical and educational skills to carry out their duties.

Rationale

An actuary is a professional who analyzes the financial consequence of risk. Actuaries use mathematics, statistics, and financial theory to study uncertain future events, particularly those of concern to insurance and pension programs. Pension actuaries, for example, analyze probabilities related to the demographics of pension plan members (e.g., the likelihood of retirement, disability, and death) and economic factors that may affect the value of benefits or the value of assets held in a pension plan's trust (e.g., investment return rate, inflation rate, and rate of salary increases). They determine the value of pension benefits and work with employers to devise strategies for funding the cost of the benefits.

In California, retirement system boards were given constitutional authority by Proposition 162 to set actuarial methods and assumptions as part of the "administration of the system." Actuaries are responsible for making method and assumption recommendations to retirement system boards, but ultimately those retirement system boards have the constitutional authority to select actuarial methods and assumptions.

While some have suggested that actuarial methods and assumptions should be legislated and uniform across the state, the Commission felt that such an approach does not take into account the unique nature of each retirement system. At the same time, the actuarial methods and assumptions chosen by a retirement system must be able to withstand the technical scrutiny of qualified professionals.

Although the American Academy of Actuaries produces and enforces actuarial standards of practice, these standards only address actuaries who practice outside the acceptable range of practice and do not help actuaries, retirement boards, and public agencies select best practice methods and assumptions. There is no single clearinghouse for funding policies and practices from around the state and country which can be used to evaluate the actuarial assumptions, crediting rates, or proposed actions of a particular retirement system.

There is a need for a strong, independent, technical group to provide comments and/or clarifications to inquiries regarding funding policies or other significant actuarial issues. Establishing a review panel which highlights best actuarial practices would provide additional guidance to actuaries making recommendations to retirement system boards and other public clients. While the review panel certainly would not mandate boards to adopt those recommendations, it would highlight best practices and be available to provide a "second opinion." In addition, such a panel would allow the public to be better educated by moving the actuarial practice into the public arena.

To attract the highest quality professionals to serve on the advisory panel and to control costs associated with that body, it is proposed that the members of the panel be appointed to set terms, receive a stipend, and be reimbursed for expenses. Permanent staff should be assigned to support the work of the advisory panel.

The panel's responsibilities could include, but not be limited to:

1. Defining the range of actuarial model policies and best practices for both pensions and OPEB benefits.
2. Developing pricing and disclosure standards for California public sector benefit improvements.
3. Developing quality control standards for California public sector actuaries.
4. Gathering model funding policies and practices from around the state and country.
5. Replying to policy questions from retirement systems around the state.
6. Commenting on complaints or conflicts regarding funding policies.

Recommendation 23

All public pension plans should have periodic performance audits performed by an independent auditor.

Rationale

State and local ordinances provide for regular financial audits of California's public retirement systems. In-depth and independent reviews of financial practices and actuarial assumptions and forecasts are critical to all interested parties, both for pensions and for OPEB benefits. Errors in an actuarial study can have severe financial consequences. Inaccurate data, wrong assumptions, or a calculation error in a current study can result in different forecasts and have long-term financial impact. Within the past dozen years, several California public pension systems have experienced significant problems regarding the quality and or accuracy of their actuarial studies.

Each year, California's public pensions are required to close their books and reconcile the financial records for the trust fund. From that closing, the Comprehensive Annual Financial Report (CAFR) is prepared for publication. These systems are then required to have their financial records audited by outside, independent, professional auditing firms to be sure they meet generally acceptable accounting rules and practices. The results are published for all interested individuals to review. Both the board of retirement and the plan's sponsor rely upon the information provided in these financial statements and the independent auditor's report. This double review significantly reduces the chances of serious errors going undetected.

Group 6 Strengthen Governance and Enhance Transparency

Current law does not provide for regular performance audits of public retirement systems. The Commission believes that such audits would be beneficial to those systems, their members, and the public. A performance audit could look at any aspect of the workings of a retirement system (administrative, investment, or benefit delivery), compare policies to practice, and provide valuable insight into how operations might be improved.

Recommendation 24

A retirement board should not provide incentives for an employer to enhance benefits, and benefit improvements by the employer should not be contingent upon a quid pro quo by the retirement board.

Rationale

There have been times when some legislative bodies, employers, and retirement system boards have worked together to manipulate aspects of the retirement system's funding policy to justify the granting of benefit enhancements. Examples of such actions have included:

- The relaxation of the employer's contribution schedule in exchange for the granting of enhanced retirement benefits;
- The artificial inflation of the value of an employer's assets by the retirement system in exchange for the granting of an enhanced benefit; and
- The use of very short amortization periods for surpluses which has allowed surplus funds to be used to pay for enhanced benefits.

The real danger in such cases is when the actuarial assumptions and methods are changed for the primary purpose of justifying a benefit increase. This recommendation is intended to protect the integrity of public retirement systems, to ensure public trust in the actions of those systems, and to avoid any appearance of collusion.

Recommendation 25

Retirement systems and public agencies should be open and transparent concerning the elements included in final compensation. All public retirement systems in California should have in place safeguards against pension spiking.

Rationale

A practice commonly referred to as "pension spiking" is generally seen as the intentional inflation of final compensation with the primary purpose of increasing the retirement benefit. Since it most often takes place shortly before retirement, the inflated benefit which spiking produces is usually unfunded. Such actions have an adverse impact on both the funding and credibility of public retirement systems. Historically, spiking has been primarily a management abuse.

Since the early 1990s, California's Legislature and public pension plans have developed numerous procedures for catching and investigating suspicious pension claims. When found to be spiking, such claims can be - and are - rejected. Examples of spiking prevention safeguards now in place in most California retirement systems include:

- Redefining, through legislation or regulation, what elements of compensation can be included in the final compensation figure;
- Clarification of when compensation items can be reported by the employer;
- Setting of computer-based compensation "triggers" which automatically flag suspicious increases for review;
- Creation and use of compensation review units to review the retirement benefits and final compensation of newly retired members, or those about to retire, to find and correct errors or spiking; and
- Authority to deny final compensation which does not meet either statutory or regulatory standards.

Commission staff asked LACERA (Los Angeles County Employees' Retirement Association), CalSTRS, and CalPERS to provide the Commission with an explanation of their spiking safeguards. Since these three systems are governed by the three major retirement laws in California, their combined responses provide a good overview of how pension spiking is being addressed in this state. Please see the Notes section of the recommendations for a brief summary of each system's approach to addressing spiking. Each system's full written response is included in the Appendix to this report.

Recommendation 26

Legislation should be enacted which would do the following:

1. Make it a crime to make a fraudulent claim for a retirement or disability benefit or to keep a payment made on the basis of a fraudulent claim;
2. Require that workers' compensation insurers and the Director of EDD provide CalPERS investigators with information they deem necessary when investigating someone concerning the application for, or the receipt of, CalPERS benefits.

Rationale

The Commission addressed the issue of disability reform because all benefits – pension and OPEB – are part of total compensation. In that light, savings on one type of benefit can lead to overall savings for the employer and/or the employees or to additional funds being available for other elements of compensation. Thus, money saved through disability reform might be used by an employer to help fund retiree health care benefits.

Over the past two decades, few disability reform bills have been both meaningful and successful, since changes in this area are most often seen as zero-sum by the various interested parties. However, there is legislation (AB 36 and AB 545) currently before the Legislature which has previously enjoyed bipartisan support, which addresses disability fraud, and whose content the Commission endorses. That content is reflected in the text of Recommendation 26.

Recommendation 27

The granting of a disability retirement should be based solely on medical information and should not consider personnel, disciplinary, or other ancillary issues.

Rationale

Within the '37 Act, each county retirement board rules on the disability applications within its own system. In addition, the Board of the State Teachers' Retirement System decides on disability applications in that retirement system. The CalPERS Board makes disability determinations for all state, school, and public agency members, except for local safety members, and also makes determinations as to whether disabilities are the result of a job-related injury or illness. Local public agencies within CalPERS have the responsibility for making disability determinations for their own local safety members, as well as for deciding whether the disability is the result of a job-related injury or illness. Consequently there can be, and has been, significant differences in standards between employers as to what constitutes a "disability," with some local agencies at times using disability retirement as a substitute for the disciplinary process. CalPERS reports that the awareness among local agencies of this disparity causes ongoing concern for some agencies over the equity of pooling disability experience as part of the rate setting process for employers participating in risk pools. This recommendation is made in order to protect the credibility of the disability claims process.

Recommendation 28

Boards overseeing pension or OPEB trust funds should evaluate not only reported actuarial liabilities and assets but also the underlying assumptions including discount rates, investment returns, mortality, health care inflation, and whether plans are open or closed systems. Boards should understand the sensitivity to changes in these assumptions, as well as the difference between actuarial values and market values. The authorities responsible for appointing members to public retirement boards should seek out individuals with expertise in the areas of public finance, investments, and public administration. In addition, the trustees of public retirement systems, as well as the trustees of OPEB trusts, should receive continuous training related to the understanding and fulfillment of their fiduciary responsibilities, actuarial methodology and assumptions, and conflict of interest requirements.

Rationale

The board members of public pension or OPEB trusts are first and foremost fiduciaries to the plan which they serve. As a fiduciary, they have both a legal and moral duty to act in the best interest of the members of the system. A lack of expertise or the claim of ignorance is no defense for the violation of their fiduciary duty.

Because of the long life of projected liabilities, minor changes in assumptions can generate surprising differences in reported outcomes. In particular, uncertainties associated with health care inflation make the range of possible outcomes for OPEB liabilities much wider than for pensions. Similarly, under GASB, liabilities are discounted by assumed investment rates, and small changes to investment policy and assumed returns can have material impacts on reported liabilities.

Traditionally, the appointed members of retirement system boards often represent the plan sponsor and provide investment and financial expertise, while the ex officio members represent the public, and the elected board members represent the plan participants. However, whether appointed or elected, all retirement system and OPEB trust board members have the overarching duty as fiduciaries to act in the best interest of the plan and its members, and should therefore receive ongoing training in order to ensure effective fund management.

Recommendation 29

Boards which govern pension and/or OPEB trusts should have very strong conflict of interest policies and should adhere to those policies. All trustees should annually attest in writing that they understand and are in compliance with the conflict of interest policy.

Rationale

In recent years, in California as well as in other states, concerns have been raised about retirement system mismanagement, misuse of funds, and conflicts of interest. Some of the specific issues include:

- The influence of board members who are beneficiaries themselves voting for special provisions from which they stand to gain, apart from other members of the system.
- Board members accepting gifts, honoraria, and other perks from investment firms.
- Board members using influence to procure contracts for campaign donors.
- Manipulating actuarial assumptions and methods to lower contribution rates and/or pay for new benefits.
- Board members using their position to market investment products.

It is very important for retirement system board members to make decisions based solely on their fiduciary responsibilities. Please see

the Notes section at the end of the recommendations for additional information on reforms that retirement systems have adopted to address board member qualifications, conflicts of interest, and other governance issues.

Recommendation 30

Boards overseeing pension and/or OPEB trust funds should meet or exceed the transparency governance requirements they place on companies or on investment managers of plan assets.

Rationale

Retirement system boards are generally in charge of overseeing pension operations, guiding investment policy, hiring investment consultants, making determinations on individual pension issues, and approving changes in actuarial assumptions. Fund governance refers to the organizational governance policies and practices adopted and followed by institutional investment funds such as retirement system boards.

Pension fund governance has received greater attention in recent years as pension funds have become larger, investment options more complex, and as pension boards themselves have placed governance requirements on the companies in which their funds are invested. The adoption of sound retirement system governance policies helps to ensure better organizational performance, fewer conflicts of interest, and the higher probability that goals and objectives will be attained. In addition to providing less opportunity for the misuse of fund assets, such policies also lend credibility to the governance requirements which retirement system trustees place on companies or on investment managers of plan assets. Examples of such governance requirements include: clear policies and practices for deciding executive compensation, the use of a clear and comprehensive conflict of interest policy, and the use of independent audit committees.

Recommendation 31

Public retirement boards of trustees should establish a separate audit committee, made up of trustees, to oversee and participate in the opening, processing, and closing of the annual audit report to the full board.

Rationale

Within a number of California's local public retirement systems, board members often do not actively participate in the audit process, leaving that role to senior staff. Best practice literature holds that the trustees should play an active part in the audit process.

Group 7 Coordinate with Medicare

Recommendation 32

Health plan sponsors should identify individuals who are Medicare-eligible and inform them of the need to enroll in Medicare in a timely manner. Employers should provide those individuals with information on penalties which result from delayed enrollment in Medicare.

Recommendation 33

Employers should provide incentives to individuals to enroll in Medicare and possibly a Medicare supplement plan once they become eligible for Medicare.

Rationale

All public employees hired since April 1986 are eligible for participation in the Medicare program. Medicare coordination refers to the practice of moving a Medicare-eligible individual from an employer's basic health care plan to a supplement to Medicare plan. Such coordination reduces employer costs by shifting first payor responsibility to the federal Medicare program. Many local governments outside of PEMHCA request that their health plan partners or third-party administrators aggressively transition individuals when appropriate.

Under existing law, CalPERS has a process to shift members to Medicare supplement plans when they become eligible for Medicare. PEMHCA stipulates that individuals who become eligible for Medicare Part A and Part B after January 1, 1985 may not be enrolled in a basic plan; if an individual chooses to enroll in Medicare, then he or she may enroll in a health plan coordinated with Medicare (Government Code Section 22844). However, information provided by CalPERS indicates that while such authority does exist, significant populations have been exempted from the requirement by Board policy. There are ongoing premium costs associated with Medicare-eligible individuals who remain in basic health plans. Individuals who delay enrollment in Medicare face life-long penalties which escalate, based on how long an individual has delayed enrollment.

The Commission recognizes that local governments can achieve considerable savings in their retiree health plans when eligible individuals enroll in Medicare. However, the Commission also recognizes that individuals may receive fewer benefits or be required to pay more out-of-pocket for health care services if they are enrolled in Medicare rather than in their local government's retiree health plan. Recommendation 33 is designed to ensure that both local governments and their retirees benefit from the retiree's eligibility for the Medicare program. This objective is best achieved if local governments offer inducements to eligible retirees to join Medicare and if retirees retain the choice of whether or not to join Medicare.

Group 8 Advocate Federal Tax Law Changes

Recommendation 34

At the request of numerous local agencies, the Commission agreed to consider several proposed tax changes. Because the Commission can play a unique role in communicating these issues to the IRS, the Commission will write a letter to the IRS recommending the following:

- **Investment of Assets Used to Fund Retiree Health Benefits**

The IRS should modify Revenue Ruling 81-100 to allow the commingling for investment purposes of the funds held to pay public employee OPEB obligations with retirement system funds, subject to appropriate safeguards. Those safeguards should require that OPEB funds must be held in trust solely for the benefit of retirees and beneficiaries and that investments and income must be properly accounted for and allocated.

Rationale

Many California public agencies are now beginning to prefund their retiree benefit obligations. Under current tax laws, it is very difficult to commingle assets held for OPEB benefits with assets held for pension obligations. Because the amount of funds currently set aside for OPEB benefits is much smaller than are pension assets, economies of scale are not available for investing OPEB funds. Therefore, net investment costs will generally be higher, reducing the net amount available to pay OPEB benefits.

- **Collectively Bargained Retiree Health Benefits**

The IRS should interpret the law in the same manner for retiree health benefits as it does for pensions, and not tax health benefits which are collectively bargained, even if they are not fully insured. The IRS also should not tax retiree health benefits that provide higher premium subsidies to retirees with longer service, whether or not those benefits are collectively bargained.

Rationale

Collectively bargained employer-provided health benefits generally are tax-free to active and retired employees. The IRS has interpreted the tax law to limit tax-free retiree health benefits that are collectively bargained, unless the benefits are “fully insured.” “Fully insured” means that the employer pays premiums to an insurer and the insurer assumes the risk to pay all health care risks. Many California public agencies, however, provide benefits that are not fully insured. Federal tax law provides that if health benefits are not fully insured, then they are taxable for the top 25% of wage earners if they “discriminate” in their favor. For this purpose, “discrimination” means the top group of employees, in terms of pay, receiving better benefits than do other employees. For the IRS, this includes giving longer term employees more retirement health care benefits, often through the use of a “vesting” schedule.

- **Saving For Retirement: Redeposits and Service Purchase**

The IRS should not change its current rules concerning pick ups and should not change its rules allowing pre-tax redeposits and the pre-tax purchase of service credit, particularly since there has been no change in the governing law.

Rationale

Federal tax law allows employers to “pick up” the members’ contributions for tax purposes only, thereby making them pre-tax. The IRS has also established that pre-tax pick up rules apply to the redeposit of previously withdrawn member contributions and to the purchase of service credit. This has allowed vested employees to redeposit previously withdrawn contributions or to purchase service credit with pre-tax dollars. The IRS is considering rule changes which would make members pay these contributions on an after-tax basis, thereby making them more expensive for employees.

- **Definition of “Government Agency” for Retirement Systems**

The IRS, DOL, and PBGC should open their process for defining “government agency” by holding public hearings and inviting government agencies and retirement systems to participate in these sessions to provide critical information before any decisions are made which could adversely affect many public employees.

Rationale

Governmental retirement plans are exempt from some federal regulation, as well as from a number of private sector IRS rules. Without these exemptions, the federal government would regulate California public retirement systems, creating a substantial increase in administrative costs.

The Internal Revenue Service (IRS), Department of Labor (DOL), and the Pension Benefit Guarantee Corporation (PBGC) are currently working on narrowing the definition of “government agency.” This project is being conducted behind closed doors and without local and state input. A narrow definition could have a negative impact on public employees whose agencies do not meet the new requirements, as those employees would no longer be allowed to participate in their current public retirement system.

- **Health Benefits: Retirees, Step Children, Domestic Partners, and All Others Covered by the Retiree Health Plan**

The IRS should not tax the health care benefits provided to everyone covered by a health care plan simply because the plan provides coverage for retirees’ step children and domestic partners who are not tax dependents of the retirees.

Rationale

The IRS has recently ruled that if any health benefits are paid for anyone other than a spouse, tax dependent, employee, or retiree - and

if the value of retiree coverage is not taken into account at the time the employee worked and earned those benefits - then the benefits for all retirees covered by the plan are taxable. Under this ruling, if a health plan covers step children or domestic partners who are not legally tax dependents, then all retirees covered under the plan are taxed on their benefits, regardless of whether they personally have a step child or domestic partner. (California law requires that domestic partners receive the same benefits as those provided to spouses.)

Notes

Section 1: Existing Disclosure Requirements for Proposed Changes to Pension and OPEB Benefits

Pension Benefits

The following provides additional details regarding several retirement systems' requirements for approving/adopting pension benefit changes, as well as mechanisms for informing the public of these changes.

CalPERS

- If an agency (other than schools) seeks to change a benefit with CalPERS, it must adopt a resolution by majority vote of the governing body stating its intent to amend its contract with CalPERS.
- Retirement benefits for classified employees of schools are not subject to collective bargaining. State legislation is necessary to change the classified retirement benefit and such legislation is applicable to all classified employees eligible for the benefit. The public is able to offer comments on the proposed change through the legislative process.
- Approval of a contract amendment cannot occur in less than 20 days following the adoption of the previously mentioned resolution.
- If the employer is a city or county, the contract approval is in the form of an ordinance, which typically requires a first and second reading no less than 30 days apart (Government Code 20471). This statute also provides that approval of the contract can occur by passage of an ordinance approved by a majority of the registered voters of the public agency.

37 Act County Systems

- Approval of pension benefit enhancements by a '37 Act county occurs with the passage of a resolution by the county board of supervisors.
- Depending on the benefit being provided, adoption of a resolution requires a simple majority, a 2/3, or even a 4/5's majority vote.
- Government Code 31592.5 requires that a '37 Act county must provide any organization that is recognized as representing retired employees with reasonable advance notice of any proposed changes to retirement benefits. The organization must be provided with a

reasonable opportunity to comment prior to any formal action by the board on the proposed changes.

CalSTRS

- Defined benefit plan retirement benefits are not subject to collective bargaining.
- State legislation is necessary to change benefits, and any change is applicable to all members of CalSTRS regardless of school district. The public is able to offer comments on the proposed change through the legislative process.

San Francisco Employees Retirement System (SFERS)

- The voters of the City and County of San Francisco have the responsibility of approving the provisions of the San Francisco Employees Retirement System plan. Changes in retiree eligibility for health, dental, and vision benefits are also subject to public vote.

Independent Public Retirement Systems

- There are no statutory provisions (except for Government Code 7507) which govern the process of enhancing benefits under an existing system.

OPEB Benefits

In contrast to the public notification requirements for pensions under Government Code 7507, no comparable cost disclosure statute exists for OPEB benefits.

Changes to PEMHCA Health Plan Benefits

- Under PEMHCA, all health plan benefit changes require approval by the CalPERS Board of Administration. All such changes occur at public meetings as formal agenda items subject to public notice requirements.
- The Board usually discusses proposed changes at multiple meetings prior to final approval. This allows affected parties time to fully understand the issues before the Board actually accepts or rejects the changes.
- In addition, the proposed changes are provided in advance of the Board meetings at constituent meetings attended by interested parties.
- Once the Board accepts a benefit change, multiple mailings are provided to the affected members explaining the change.

Contracting with PEMHCA

- Public agencies contract for health benefits under PEMHCA by adopting a public resolution.
- There is no requirement for the preparation of an actuarial valuation or to notify the public of the cost of the benefit.

Notes

Section 2: Pension Spiking Safeguards in Place by LACERA, CalPERS, and CalSTRS

Commission staff asked LACERA (Los Angeles County Employees' Retirement Association), CalSTRS, and CalPERS to provide the Commission with an explanation of their spiking safeguards. Since these three systems are governed by the three major retirement laws in California, their combined responses provide a good overview of how pension spiking is being addressed in this state. Each system's full written response is included in the Appendix to this report.

LACERA

LACERA is the largest of the twenty county retirement systems operating under the County Employees' Retirement Act of 1937 ('37 Act). More than with CalPERS or CalSTRS, the '37 Act retirement systems have had spiking defined and regulated by the courts. Through a combination of court rulings and legislation, the '37 Act counties have decided what compensation elements are reportable to the retirement system to be used as the basis for calculating a pension. Such compensation is generally referred to as "pensionable earnings." The '37 Act defines "pensionable earnings" broadly to mean cash paid to an employee.

In 1983, the California Court of Appeal ruled that pensionable earnings should be limited to only those items of compensation which were paid in cash to all members in an employment classification. This excluded compensation paid for such things as bilingual pay, educational incentive pay, and any other pay which was paid to only those employees with special qualifications.

In 1997, the California Supreme Court issued its final decision in Ventura County Deputy Sheriffs' Association v. Ventura County Employees' Retirement Board. In this decision, the Supreme Court ruled that the 1983 Court of Appeal had been incorrect and that cash paid to employees for services rendered for other than regular pay for time worked was pensionable.

Following the Ventura decision, LACERA developed a list of compensation items which were pensionable as well as items which were not. That list was placed in the '37 Act law along with guidelines for the collective bargaining process necessary to make changes to the list contained in statute.

As an ongoing guard against spiking, LACERA's legal department reviews all MOUs between the county and its employees to determine if any new pay items are pensionable.

Another safeguard against spiking comes from the LACERA computer system's ongoing edit of all payroll information received from employers. When something is flagged by this edit, it is investigated by staff to determine whether it is pensionable. Finally, there is a manual examination of the records of those employees nearing retirement or

those who are newly retired, which can result in error corrections paid by either LACERA or the employee. LACERA reports that it can and does reduce pensions based on “spiked” data.

CalPERS

In the early 1990s, the **Sacramento Bee** ran a series of investigative articles on pension spiking which constituted the first systematic examination of how spiking was being conducted by some public agencies. Spurred on by these and other media reports, the Legislature introduced several pieces of legislation aimed at ending spiking.

Of these bills, the CalPERS-sponsored SB 53 (Chapter 1297, Statutes of 1993) was the most extensive. The effect of SB 53 was to place guidelines in the CalPERS’ law directing the CalPERS Board to develop regulations setting out which items could be included in final compensation and which items would be specifically excluded.

CalPERS has statutory authority to deny increases in compensation for pension purposes which do not fit its guidelines for determining final compensation, and it reports that denials occur on a regular basis.

CalSTRS

The Education Code provides guidelines for defining “creditable compensation.” As with the other systems above, these guidelines include requirements that:

- Compensation be treated consistently throughout an employee’s career;
- Compensation be consistent throughout an entire classification of employees; and
- Compensation be excluded which is paid for the principal purpose of increasing an employee’s final compensation in order to enhance the pension benefit.

CalSTRS reports that it uses these guidelines and others to decide what elements of compensation may constitute spiking.

CalSTRS also informed the Commission that an important tool it uses to prevent spiking is the school district audit, along with its statutory authority to disallow compensation which it finds is paid principally to increase the pension benefit. Further, CalSTRS staff reports that they are statutorily authorized to reduce spiked pensions and do so.

Before the publication of the **Sacramento Bee** articles mentioned above, spiking was a problem in many of California’s public pension systems. There were very few guidelines and a great deal of creativity on the part of some public employers. And even if spiking was discovered, pension systems had no authority to reduce pension benefits. Since that time, however, systematic procedures have been adopted by the major systems, and spiking, while not eliminated completely, is a much less serious problem.

Notes

Section 3: Governance Reforms Adopted by Retirement Systems

Retirement systems have adopted a variety of reforms to address board member qualifications, conflicts of interest, and other governance issues.

In 1998, CalPERS unsuccessfully attempted to restrict campaign contributions from investment firms to the two ex officio elected officials on the Board in the wake of a controversy related to that issue.

In September 2007, the CalSTRS board voted to approve rules which limit campaign contributions by money managers to the Governor and other public officials with influence over the pension fund. The regulations are aimed at investment managers and their firms that do at least \$100,000 per year in business with CalSTRS as well as those negotiating to contract with the fund. The provisions of the rule include:

1. An aggregate annual contribution limit of \$5,000 from a firm and \$1,000 maximum from an individual.
2. Barring violators from doing new business with the fund for two years.
3. Allowing firms 90 days to disclose an inadvertent violation.
4. Requiring board members to recuse themselves from investment decisions involving campaign contributors.

Similar concerns about the relationship between the financial industry and county retirement boards led to AB 246 (Chapter 315, Statutes of 2007), which prohibits a member of a '37 Act county retirement board from selling or providing investment products to any other '37 Act retirement system.

In 2004, California's State Association of County Retirement Systems (SACRS) drafted the Uniform Trustee Appointment Policy to recommend application and appointment procedures as well as qualifications for retirement board members appointed by county boards of supervisors. SACRS urged '37 Act County boards of supervisors to use these recommendations to enact a county policy on the appointment of members to the board of retirement when a term expires or a vacancy occurs.

SACRS recommends that the appointment policy consist of three parts: (1) a procedure for filing applications; (2) a set of recommended qualifications for appointment; and (3) a procedure for selecting the best qualified candidates.

The recommended qualifications for an appointee to the board of retirement include the following:

1. Experience as an executive financial manager in a public agency or private enterprise.
2. Experience developing, planning, and implementing investment and money strategies.

3. Experience in the interpretation of executive level financial reports and correspondence.
4. Experience in the human resources and employee benefits arena.
5. A commitment and willingness to spend the necessary time to perform the work of a Board member.

Public Employee Post-Employment Benefits Commission Members

GERALD PARSKY

Chair of the Commission, currently serves as Chairman of the Aurora Capital Group, a Los Angeles-based investment firm. From 1977 to 1992, he was a senior partner and a member of the executive and management committees of the Los Angeles law firm Gibson, Dunn & Crutcher. Prior to going into private practice, Parsky served as Assistant Secretary of the U.S. Treasury Department in charge of international affairs and capital markets from 1974 to 1977. He has served on the University of California, Board of Regents since 1996, and served as Chairman of the Regents from 2004 until 2007. Parsky was appointed to the Commission by the Governor.

MATTHEW BARGER

is a senior advisor at the San Francisco private equity investment firm Hellman & Friedman LLC, where he has worked in a number of roles, including managing general partner and chairman of the investment committee since 1984. His primary focus has been asset management. Barger was appointed to the Commission by the Governor.

PAUL CAPPITELLI

is the Executive Director of the California Commission on Peace Officer Standards and Training (POST). Cappitelli recently retired as a Captain from the San Bernardino County Sheriff's Department, where he served in various assignments for over 29 years. Cappitelli has been active with the California Peace Officers' Association (CPOA) since 1992, serving as the association's president in 2006-2007. Additionally, he is a member of various professional groups and associations, including the International Footprint Association, American Jail Association, and International Association of Chiefs of Police. He has served on the Board of Directors of the Sheriff's Benefit Rodeo charitable organization, the Community Board of Trustees of the Chino Valley Medical Center, and the CSU San Bernardino Public Administration Advisory Group. He was appointed to the Commission by the Governor.

JOHN COGAN

currently serves as a senior fellow at the Hoover Institution and as a professor in the public policy program at Stanford University. In addition, he serves on the faculty advisory boards for the Stanford-in-Washington Program and the Stanford Institute for Economic Policy Research. During the Reagan Administration, Cogan served as Deputy and Associate Director in the U.S. Office of Management and Budget and as Assistant Secretary for Policy for the U.S. Department of Labor. Cogan currently serves as a member of Governor Schwarzenegger's Council of Economic Advisors. Cogan was appointed to the Commission by the Governor.

CONNIE CONWAY

chairs Governor Arnold Schwarzenegger's California Partnership for the San Joaquin Valley, a 28-member public-private panel focusing on regional economic and smart-government policies. She was elected to the Tulare County Board of Supervisors in 2000 and will serve as chair in 2008. Prior to her election, she was district manager of CorVel Corp., a nationally certified health care organization specializing in workers compensation disability management. Conway, a past-president of the California State Association of Counties, is also a director of the National Association of Counties, chairing its membership committee. Conway was appointed to the Commission by the Governor.

RONALD COTTINGHAM

was first elected president of the Peace Officers Research Association of California (PORAC) by unanimous vote on November 23, 2003. He has been re-elected by unanimous vote to three additional terms and is now in his fourth year as PORAC President. PORAC is a federation of local, state, and federal public safety associations. PORAC has over 750 member associations, representing a total of 60,000 individuals. PORAC is the largest state-wide public safety association in the nation. Cottingham has a diverse background in labor representation and law enforcement. He has been continuously employed by the San Diego Sheriff's Department since 1973 and currently holds the rank of Lieutenant. Cottingham is a legislative appointee to the Commission.

TERESA GHILARDUCCI

is one of the nation's preeminent experts on employee retirement pensions. Ghilarducci currently serves as a trustee of the General Motors Retiree Health Fund. She is a past presidential appointee to the advisory board of the Pension Guaranty Corp and a trustee of the Indiana State Employees' Pension Fund. She is a Professor of Economics at the University of Notre Dame and serves as the director of Notre Dame's Higgins Labor Center. She is also the 2006-2008 Wurf Fellow at Harvard Law School's Labor and Worklife Program. The author and editor of dozens of articles and books on pensions and retirement, Ghilarducci has testified before Congressional committees on Social Security, retirement, and pension issues. Ghilarducci is a legislative appointee to the Commission.

JIM HARD

is President of California's largest union of state employees, Service Employees International Union, Local 1000. Hard's union represents the interests of nearly 90,000 workers. He has worked with both Republican and Democratic administrations on labor-management issues, including pension benefits, health benefits, disability insurance, and reforming the discrimination complaint process in state service. Hard is a 32-year state employee with the Employment Development Department. Hard is a legislative appointee to the Commission.

LEONARD LEE LIPPS

was a teacher in California's schools for twenty years. He currently serves as a regional manager of the California Teachers' Association working with school districts on budget analysis, State Teacher's Retirement System issues, and the economic impact of state legislation on education finance. Lipps has worked as the lead trainer for countless seminars provided to fellow educators around California on school finance and teacher retirement issues. Lipps is a legislative appointee to the Commission.

DAVE LOW

is the Assistant Director of Governmental Relations for the California School Employees Association (CSEA). In this capacity, he is responsible for lobbying and legislative advocacy, political action, policy development, legislative analysis, political campaigns, and political and legislative training and education. He also manages CSEA's governmental relations staff. Low works with federal, state, and local elected and appointed officials on education and labor issues. Low is a legislative appointee to the Commission.

CURT PRINGLE

currently serves as Mayor of the City of Anaheim and President of Curt Pringle & Associates. Also, since 2000, he has served as an adjunct faculty member in the political science department at the University of California, Irvine, where he teaches California government. Previously, he served in the California State Assembly from 1988 to 1990 and from 1992 to 1998. While in the Assembly, Pringle served as Speaker of the Assembly in 1996. Pringle was appointed to the Commission by the Governor.

ROBERT WALTON

retired in 2005 after 34 years in state government, including over 30 years with CalPERS. While at CalPERS, he served in many capacities including Assistant Executive Officer for the last 17 years. Walton has extensive experience in fiscal, actuarial, and health benefit management. During his time at CalPERS, the fund's total assets grew from about \$4 billion to well over \$200 billion. Walton was a member of the Governmental Finance Officers Association and the National Conference of Public Employee Retirement Systems. Walton is a legislative appointee to the Commission.

Public Employee
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Benefits Commission

Additional
Resource Material
and Appendix

Additional Resource Materials for Public Agencies and Appendix Materials

Public Employee
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Additional
Resource Material
and Appendix

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- Appendix 1** **Brief History of Pension and OPEB Benefits in California**
Two documents chronicling the important developments in California’s pensions and health care benefits over the past several decades.
- Appendix 2** **Explanation of GASB 45**
A brief explanation of what GASB 45 does and does not require of public agencies.
- Appendix 3** **How to Read an Actuarial Valuation**
A step-by-step guide to understanding the components of an actuarial valuation.
- Appendix 4** **Actuarial Assumptions in Use in California’s Public Sector**
A graphic comparison of the actuarial assumptions currently used by twelve of California’s largest retirement systems.
- Appendix 5** **OPEB Funding Approaches**
A comparison of several federally-approved funding vehicles available to fund OPEB benefits.
- Appendix 6** **Executive Summary, Gabriel, Roeder, Smith and Company (GRS) Report to the State Controller**
Executive summary of the May 7, 2007 actuarial valuation determining the GASB 45 OPEB liability of the State of California.
- Appendix 7** **Alternate GRS Scenarios**
Sensitivity analyses concerning the impact of the health care inflation assumption on the State’s GASB 45 OPEB liability.
- Appendix 8** **Fiduciary Responsibilities of Public Pension Trustees**
A brief overview of the duties and responsibilities of plan fiduciaries.
- Appendix 9** **Responses to “30 Ways to Spike Your Pension” Document**
Full written responses of LACERA, CalPERS, and CalSTRS to testimony concerning the practice of “pension spiking.”
- Appendix 10** **Glossary**
A glossary of important terms used in this report.
- Appendix 11** **Acknowledgements**

Appendix 1

Brief History of Pension and OPEB Benefits in California

Pension Benefits

In 1913, the California State Teachers' Retirement System (CalSTRS) was created to provide a longevity benefit of \$500 per year (equivalent to \$10,500 in 2007) to public school teachers who worked at least 30 years, regardless of age at retirement. The longevity benefit would have replaced more than 50% of compensation in retirement, since teachers' salaries at the time were about \$53.65 per month in rural areas and about \$70.65 in urban areas.¹ In 1935, the longevity benefit was increased to \$600 per year. Because of declining purchasing power, the \$600 longevity benefit would have been equivalent to only \$9,150 in 2007. The CalSTRS system was changed to a defined benefit plan in 1956, using a formula that provided one-half of pay for a member at age 60 with 30 years of service.

Both the State Employees' Retirement System (SERS), the precursor to CalPERS, and the San Francisco City Employees' Retirement System were created in 1932. The County Employees' Retirement Law of 1937 ('37 Act) established the authority for counties to establish independent retirement systems. Many of the twenty counties currently operating retirement systems under the provisions of the, '37 Act created those systems in the mid-1940s.

While the primary purpose of the systems is to provide a pension benefit upon retirement from active employment, the systems may also provide lifetime benefits to the member in the event of a disability and to a qualified survivor in the event of a member's death. The amount of a disability benefit

varies among systems and, except at CalSTRS, is dependent on whether the disability was caused as a result of job-related activities. Likewise, the amount of any death benefit varies among systems and is dependent on whether the member was actively employed or retired at the time of death and whether the death occurred in the line of duty.

The initial CalPERS and '37 Act county retirement systems generally aimed to provide their retirees with a service retirement benefit equaling roughly one-half of pay. The CalPERS retirement benefit reached this target at age 65 after 35 years of service. The one-half of pay was calculated based on an average of five consecutive years of compensation.

The first retirement formula for a safety classification² was established for the California Highway Patrol (CHP) in 1935. This formula provided one-half of average pay at age 60 with 20 years of service. The benefit formula's lower retirement age (60 rather than 65) was based on the principle that retirement benefits should provide for a younger, more physically capable public safety workforce. While a number of safety formulas have since been added to the CalPERS and '37 Act retirement systems, that principle is still applied to pension benefits offered to safety members today.

Significant changes in CalPERS' retirement benefits began in 1945 when legislation created new formulas for state employees to provide one-half of pay at a younger retirement age: age 60 with 30 years of service for miscellaneous employees and age 55 with 20 years of service for CHP employees. Not only

was the retirement age reduced by five years, but the minimum retirement age was also reduced to 55 for miscellaneous members, at which time a discounted benefit would be provided. In 1953, the average monthly compensation upon which CalPERS' benefits were calculated changed from a five year average to a three year average.

In 1961, the State decided to provide Social Security coverage for its non-safety employees. To coordinate pension benefits with the new Social Security benefit, legislation was passed to create a lower retirement formula for the future service of employees who chose to participate in Social Security. (Since CalSTRS members voted on a number of occasions to not join Social Security, the lower formula was not applicable to members of CalSTRS.) Some '37 Act counties also offered new, lower formulas for coordination with Social Security. Since that time, however, most—if not all—of those lower formulas have fallen out of use.

During the 1970s, there were a number of changes impacting the pension benefits of California public employees. One of those changes was the use of the concept of “total compensation”, which was used to determine the right balance between wages, pensions, and health benefits. The total years of service required for miscellaneous members to achieve one-half of pay at age 60 declined to 25 years. During this time, local public agencies were provided additional contract options through CalPERS. The '37 Act was amended in 1970 to permit counties to calculate retirement benefits using a one year average of monthly pay (twelve consecutive months). The same option became available to CalPERS local public agencies in 1974 and to state and classified school employees in 1990.

There was a change in 1981 when the '37 Act was amended to allow specified counties to establish lower tier retirement formulas for new employees. The State adopted a similar approach in 1984 by creating a lower, second tier of benefits for miscellaneous employees. The State's second tier formula was funded entirely by the employer (no employee contributions) and provided one-half of pay at age 65 with 40 years of service.

In 1990, legislation was enacted that allowed public agencies participating in CalPERS to offer a retirement formula which would achieve one-

half of pay at age 55 with 25 years of service for miscellaneous employees. During the 1980s when pension benefits were being reduced for new hires and the 1990s when pension benefits were largely unchanged, there was also an increasing use of legislation to reclassify positions into industrial or safety classifications which provide higher retirement formulas. This reclassification was often justified as a money-saving measure. That was because when miscellaneous employees in Social Security were made safety employees, they were removed from Social Security, causing both the employer and employee to no longer pay the Social Security tax.

Faced with teacher shortages in the late 1990s, the Legislature added benefit improvements for teachers who retired with 25 or more years of service to encourage career longevity, which resulted in an immediate increase in the average length of service of approximately 1.7 years. Two years later, however, the average length of service fell to approximately 29 years, where it had been before the benefit improvement. While length of service currently appears to be on the rise, it is not yet clear whether this pension enhancement will achieve the desired increase in career longevity over a longer period of time.

The most significant pension benefit legislation of the past few decades was signed in 1999. SB 400 (Chapter 555, Statutes of 1999) created the “2% at 55” formula for state miscellaneous employees which achieves one-half of pay at age 55 with 25 years of service. The legislation also increased the retirement formulas for the California Highway Patrol, correctional guards, and other state safety positions. These increased formulas resulted in the member achieving a retirement benefit equal to one-half of pay at age 50 with 16.667 years of service for CHP officers, at age 55 with 16.667 years of service for correctional guards, and at age 55 with 20 years of service for other state safety employees. AB 1937 (Chapter 237, Statutes of 2000) provided authority for '37 Act counties to provide the same safety formulas made available under SB 400.

The following year, AB 616 (Chapter 782, Statutes of 2001) established three additional enhanced retirement formulas for miscellaneous employees which became available as contract options for local agencies participating in CalPERS and for '37 Act

counties. The three new optional formulas allow a miscellaneous employee to retire with one-half of pay at: age 55 with 20 years of service; age 55 with 18.5 years of service; or age 60 with 16.667 years of service. The list of optional contract amendments for CalPERS contracting public employers has now expanded to include over 50 ancillary benefits and over 10 retirement formulas.

Funding

CalSTRS Employer/Member Contributions

CalSTRS' original 1913 longevity award was funded by 5% of the annual revenue generated by the inheritance tax, as well as an employee contribution of \$12 per year. When the benefit was increased in 1935, the employee contribution was increased to \$24 per year, and school districts began paying \$12 per year per employee.

In 1944, the Legislature changed the employee contribution rate to a percent of salary based on the employee's age when membership was established, while the employer continued to contribute \$12 per year per eligible employee. The State's contribution changed from a percent of the inheritance tax to a pay-as-you-go annual appropriation. The Legislature then increased the employee contribution rates four times between 1944 and 1956 without changing the employer contribution rate or the State's pay-as-you-go appropriation. When CalSTRS became a defined benefit plan in 1956, the employer contribution was increased to require a contribution of 3% of payroll, while the State continued its pay-as-you-go funding. By this time, the employee contribution had been increased to between 9.53% and 13.52% of salary.

In 1972, projections indicated that the State's annual pay-as-you-go contributions to CalSTRS would increase from \$71 million in 1967/68 to \$635 million by 1989/90. As a result, legislation changed the funding from pay-as-you-go to actuarial prefunding and changed the member contribution rates from a variable rate based upon the employee's age at membership in the retirement system to a fixed 8% contribution rate. The school districts' contribution rate moved from approximately 2% of payroll to 8%. In addition, the State was obligated to pay \$130 million per year for the next 30 years to amortize the system's unfunded liability. Subsequent legislation increased the annual State appropriation to \$144.3 million and instituted an additional annual

appropriation of \$10 million that was scheduled to increase to \$280 million over a 15-year period.

Unlike most defined benefit programs, both the member and the employer contribution rates to CalSTRS are fixed amounts specified in statute. When investment earnings are not adequate to fund the portion of benefits not covered by the fixed member and employer contributions, the State is the only other source of revenues. During financial market downturns, the funded status of the CalSTRS defined benefit plan may suffer more severely than a pension plan which allows for fluctuating employer contribution rates.

CalPERS Employer/Member Contributions

Prior to 1970, CalPERS member contribution rates, combined with investment income from those contributions, were generally designed to fund one-half of the retirement allowance, with the employer making up the other half. To achieve this result, the employee contribution rate was based on the employee's age at employment; younger employees paid less over a longer period of time, while employees hired at an older age were charged a higher contribution rate to reflect their shorter anticipated career until retirement. After 1970, the employee contribution rate changed to a fixed percentage of pay, with the percentage specified in statute.

Since its creation, CalPERS has functioned as a traditional defined benefit plan, with the employer responsible for funding the difference between promised pension benefits and the revenues generated by member contributions and investment earnings. An annual actuarial valuation looks at the status of each plan's assets and liabilities, and the actuary uses that information to determine the required employer contribution rate for the following fiscal year.

Investments

Investment income is one of the major funding sources of pension benefits, typically producing at least 75% of the funding needed to pay for retirement benefits.

When the State Constitution was amended in 1932 to create SERS, pension funds were only allowed to invest in bonds. In 1953, the Constitution was amended to allow investments in real estate. In 1966, Proposition 1 again amended the State Constitution to permit public pension plans (other than CalSTRS) to invest up to 25% of their portfolios in public

equities, and in 1984, Proposition 21 removed that 25% limit on public equity investment. Allowing the pension systems to invest in asset classes with greater market volatility also created the ability for pension systems to generate higher investment returns.

The assumed rate of return on investments is one of the most significant actuarial assumptions in terms of overall impact on employer contribution rates. Looking at the historical assumed rates of return for CalPERS, as an example, one can see a correlation to the expanding investment authority described above. CalPERS' assumed rate of return was set at 4% in 1932 and was reduced three times by the Board of Administration until it reached 2.5%. It remained at that level from 1944 to 1958. By 1968, the Board had gradually raised the rate to 4.5%. Between 1968 and 1991, the assumed rate of return was gradually increased to 8.75%. Since 1991, CalPERS' assumed rate of return has been reduced three times, primarily due to rising inflation estimates, to the present 7.75% (adopted in 2003).

An ongoing challenge for pension fund trustees is the matching of benefit liabilities with the revenues assumed to be generated by investment earnings. While riskier investment portfolios create greater returns and require smaller employer contributions, the volatility of those investments also creates greater volatility in asset value and, in turn, greater volatility in employer contribution rates. Until 1984, only 25% of a portfolio could be invested in equities. Since then, pension funds have had twenty years to create more complex investment portfolios using a broader array of asset classes, with overall investment earnings increasing substantially. However, learning how to manage a more volatile portfolio's impact on employer rates, particularly during different market cycles, has taken time.

The most severe example of the failure to match liabilities with revenues occurred during the late 1990s, when many retirement systems saw a dramatic increase in the value of their investment holdings. Because of several years of investment earnings which were significantly higher than the assumed rates, many pension systems became greatly overfunded (often 120% or more). While pension fund trustees did not expect double-digit investment returns to continue indefinitely, it was widely believed that even if returns dropped to historic levels (meaning the actuarial assumed rate of return) the plans would

continue to have significantly more assets than needed to fund current benefit levels. As a result, many retirement systems allowed employers to reduce or discontinue employer contributions to the system, since additional assets were not believed to be needed. Some employers also opted to increase benefit levels, since the excess assets were believed to be adequate to cover any ad hoc cost of living increases for current retirees or any unfunded liability created as a result of retroactive benefit enhancements for active employees.

However, instead of investment returns tapering off to the assumed rates of return, the financial markets fell steeply for three consecutive years, one of the most significant periods of decline ever experienced by the financial markets. As a result, the value of pension fund assets abruptly dropped to a point where the assets were no longer sufficient to both pay for promised benefits and continue the reduced employer contribution rates. Instead, employer contribution rates were re-established at levels not seen in some time, while employers who had adopted pension enhancements had a new "normal cost" reflecting those higher benefit level. The drastic increase in employer contribution rates resulted in serious budgeting problems for some agencies, particularly those that had expanded spending for other programs when pension contributions were reduced.

While this example represents one of the most extreme cycles in the history of financial markets, it demonstrates that pension systems continue to face new obstacles in managing the volatility of assets. As a result of this period, some pension systems have become more cautious about using "excess" assets, while others have implemented longer "smoothing" periods. Smoothing periods try to dampen the impact of the fluctuating market value of assets by creating a longer period of time before investment earnings will be fully accounted for in the actuarial valuation used to set employer rates. Pension fund trustees are likely to continue refining their plans and strategies as they learn through future experiences.

Other Significant Events: Plenary Authority

In 1992, voters passed Proposition 162 in response to a series of "raids" by the Legislature and the Governor on CalPERS and CalSTRS pension funds to help

balance the state budget. Prior to Proposition 162, similar problems were seen at the local level when some employers failed to make full payments to their county pension systems in order to finance other county spending priorities. The voters agreed that the pension funds belonged to the members who had accrued those benefits, and employers had no right to “borrow” those assets.

Proposition 162 gave “plenary authority” to the trustees of all California public pension plans over the administration and investments of their systems. In constitutional law, plenary authority is generally interpreted as a power that has been granted to a body with no limitations on how that power may be used, and the assignment of plenary authority to one body divests all other bodies from the right to exercise that authority.

This new autonomy provides a great degree of protection for pension fund assets, but it also creates a grey area in the authority over pension systems, particularly as it pertains to legislative oversight. While pension funds are independent in their administration, they are still subject to state laws enacted by the Legislature. At times it is unclear whether state laws may violate the systems’ plenary authority, and there have been legal challenges to determine where this line in the sand is to be drawn.

Over the past 75 years, public pensions have been an important form of deferred compensation and a useful tool for public employers to recruit and retain public employees. There has been a continuing evolution in the complexity and professionalism of those systems, as well as a significant increase in their autonomy. Pension systems will continue to evolve as lessons are learned, particularly lessons learned through adverse circumstances. The experiences of the past decade should create the practical knowledge necessary for pension systems to design greater stability for the future.

OPEB Benefits

In 1961, the State of California began offering basic health benefits to its employees and retirees. The Public Employees’ Medical and Hospital Care Act (PEMHCA) provided that the State would offer \$5 per month to both active and retired employees,

with the benefit administered through the State Employees’ Retirement System (SERS) – the predecessor to the California Public Employees’ Retirement System (CalPERS). At the time, the Office of the Legislative Analyst (LAO) estimated the total annual cost for the benefit, including administrative costs, would be \$7.1 million. (The \$5 monthly contribution would now be worth \$34.86 in purchasing power, significantly less than the State’s current contribution for health benefits.³)

The rationale for providing the benefit was identified in the December 1960 report of the Assembly Interim Committee on Civil Service and Personnel, Medical Care Insurance for State Employees and Other Civil Service Problems. The Assembly Committee recommended that the State establish and partially finance basic medical care insurance to:

- Promote increased economy and efficiency in state service.
- Enable the State to attract and retain qualified employees by providing health benefits plans similar to those commonly provided in private industry and other public jurisdictions.
- Recognize and protect the State’s investment in each permanent employee by promoting and preserving good health among state employees.

A particular concern identified in support of creating the new health care benefit was the fact that many California local government agencies and the federal government provided such benefits to their employees.

Prior to PEMHCA, state employees were not provided health benefits but were able to purchase group health and life insurance through membership in the California State Employees Association (CSEA). Starting in 1931, one of the first benefits of membership in CSEA was access to insurance products at group rates which were not otherwise available to an employee of the State. By the 1950s, CSEA had successfully sponsored legislation to allow retirees access to its group policies and to have premium payments paid through retirement check deductions. In addition to CSEA, there were a number of other labor and employee organizations, health care and insurance organizations, and the University of California, which supported the legislation to provide retirees access to health coverage.

The State created its own employer-provided health program in 1961 with the creation of PEMHCA. In 1967, PEMHCA was amended to allow local agencies to contract with CalPERS to provide health benefits to their employees.

The employer contribution for state employees was periodically increased through statute, until the contribution was changed in 1974 from a dollar amount to a percentage of premiums. At that time, the State provided an employer contribution based on 80% of employee or retiree costs, plus 60% of dependent costs. In 1976, the employer contribution for the employee and retiree was increased to 85%. In 1978, what is now referred to as the 100/90 formula was put into place for state employees and retirees. The 100/90 formula bases the employer contribution on the weighted-average premium costs for the four health plans with the largest number of state employees enrolled in the prior year. The State's contribution is calculated to equal 100% of the weighted-average health plan premium for single-party enrollment, plus 90% of the additional amount required for dependent coverage.

In 1981, a dental plan was added to the State's benefit package.

By 1984, State costs for OPEB benefits exceeded \$100 million, and legislation was passed to increase the number of years a state employee hired after January 1, 1985 must work in order to receive the employer contribution for retiree health benefits. Prior to this legislation, state employees only had to work for 5 years to earn the full employer contribution for retiree health benefits for life. Therefore, state employees hired prior to 1985 are eligible for the full employer contribution for health benefits upon retirement with only 5 years of service.

The State amended the vesting criteria again just a few years later. A new vesting schedule was created for all represented state employees hired after January 1, 1989 and for all excluded or non-represented employees hired after January 1, 1990. For the members of both those groups, with ten years of service, they receive 50% of the contribution in retirement, increasing 5% annually until the full contribution is earned with 20 years of service credit. State employees subject to this vesting schedule must

work a minimum of ten years to receive any employer contribution for retiree health benefits. Employees retiring with at least five years of service, but before becoming eligible for an employer contribution, are eligible to purchase coverage under a PEMHCA-sponsored health plan at their own expense.

In 1991, the State moved away from the 100/90 formula for active employees but retained the contribution formula for retirees. Active employees now receive a contribution that is negotiated as part of collective bargaining arrangements. The most recent agreements generally provide for an employer contribution equaling 80 or 85% of the average single-party and family health plan premium.

Throughout this period, employer health care costs were relatively stable but began to accelerate rapidly in the middle to late 1990s. The early 1990s had low year-to-year increases, with a few years showing an actual decline in premiums. These were the years of strong managed care plans capable of negotiating favorable reimbursement contracts with providers and able to restrain service utilization.

CalPERS participated in this trend by relying on what was referred to as the "managed competition" model, which was seen by many as a possible model for the delivery of health care in the nation as a whole. Under this model, it was expected that premium increases would be restrained by competition among health plans, all of whom would be required to offer the same benefit package. Members would be provided with a choice of health plans competing for membership on the basis of cost and quality. The model assumed a number of vertically integrated "staff model" HMOs with unique provider networks competing for market share. Under the staff model, the HMO directly employs physicians and provides services in facilities owned by the HMO. A vertically integrated health plan not only hires physicians and other health care providers, but also owns or manages the full range of health facilities from clinics to hospitals and pharmacies. The economics of the health care delivery system made it difficult for staff model HMOs to compete throughout the state with the exception of one unique provider, the Kaiser Permanente plans.

The nature of the competition envisioned by the model never really took hold, even in California where managed care plans quickly established themselves as the predominate players in the marketplace. Instead, the market evolved into health plans contracting with essentially the same networks of providers, otherwise known as the “network model” HMO. Under the network model, health plans can contract with providers as needed to meet capacity needs without the costs of facilities or physicians that may not be adequately used.

For CalPERS, this meant the cheapest health plan option was usually the Kaiser HMO, which was available mostly in select urban areas. The more expensive network HMOs were more likely to be available throughout the state. Although in rural areas, often no HMO option was available at any price.

By 1988, the State began to provide a rural subsidy to members and retirees who reside in areas without available HMO coverage. (For many years this subsidy was also available to out-of-state retirees, but this part of the program has been eliminated.) In 1993, CalPERS also began offering a self-funded preferred provider plan (PPO), PERSChoice, to ensure the availability of health plans throughout the state regardless of HMO service areas.

Beginning in the late 1990s, costs began to increase as a result of consumer and political backlash against utilization restrictions. Combined with cost increases associated with changing demographics and the growing availability of expensive procedures, the low (or negative) year-to-year changes were replaced with double-digit annual increases even for large purchasers like CalPERS. All public agencies in California were now confronted with increasing benefit costs. The health plans providing services to state employees all began to increase premiums and the managed competition model rapidly moved out of vogue.

By 2003, the CalPERS Board confronted what it considered to be unacceptable premium increases (in excess of 20%). To combat this situation, CalPERS abandoned the last vestiges of the managed competition model by eliminating a significant number of HMO plans. Interested plans were asked to submit a last and final premium offer assuming that only one network HMO would retain an

exclusive CalPERS contract in exchange for the lowest premium and a willingness to retain some services areas in rural and semi-rural counties. CalPERS went from ten HMOs to three, with Blue Shield remaining as the “statewide” network HMO along with Kaiser and a small regional HMO, Western Health Advantage, in the Sacramento area. (Western Health Advantage’s contract was not renewed for 2008. CalPERS now only offers two HMOs and the self-funded PPO plans. CalPERS has gone from a multiple plan competitive model to a limited number of plans where CalPERS tries to leverage its size and purchasing power in order to achieve rate stability.)

At the same time benefit costs were increasing, discussions began around the accounting rules for the reporting of public agency retiree health benefits. In 1993, the Financial Accounting Standards Board (FASB) issued rulings (FASB 106) that required all public companies in the United States to account for the cost of retirement health care for all current and future retirees and their covered dependents. The public sector equivalent, the Governmental Accounting Standards Board (GASB), then began discussions with interested parties to implement similar reporting requirements for all public agencies. In 2004, GASB released Statement 45 (GASB 45) concerning health and other non-pension benefits, known as Other Post-Employment Benefits (OPEB) for retired public employees. Health benefits represent by far the most significant cost associated with these benefits.

Unlike pension benefits, the majority of state and other public agencies have not prefunded OPEB costs. Now, under GASB reporting requirements, these costs will need to be systematically identified, valued, and reported on the public agency’s balance sheet.

In the private sector, as these reporting requirements went into effect, companies took actions where possible to limit, or even eliminate, these retiree health benefit liabilities. Some companies simply eliminated retiree health benefits altogether. Others adopted strategies to scale back benefits or shift costs to retirees. The issue of employee and retiree health coverage in the private sector continues to be a major issue seen in collective bargaining and court cases on a regular basis. The result has been a continual

decline in employer-sponsored health care, with retiree coverage becoming increasingly scarce.

Currently, employer-sponsored health care for retirees is far more likely to be provided by a public agency than by a private company. According to a 2005 Mercer survey, in California, the public sector offers retiree health coverage at almost three times the rate as in the private sector.⁵ This is true whether or not retirees are eligible for Medicare coverage. In addition, when health coverage is offered, private employers are far more likely to limit retiree benefits or the employer contribution than are public employers. Public employers are also less likely to vary contributions by age or years of service or to reduce benefits after a certain age.

Even with these overall trends, there are indications that some public agencies are beginning to respond to the GASB 45 reporting requirements in a fashion similar to the private sector reaction to the FASB

reporting requirements. Testimony presented before the Commission, responses to the Commission's OPEB survey, and case study profiles included in this report provide examples of public agencies that are re-evaluating their approach to providing OPEB benefits. Options such as capping and reducing financial contributions, placing retirees in separate risk pools, or shifting additional costs to employees and retirees have occurred in recent months.

While employers, employees, and retirees seem to consistently rate an employer-sponsored health plan as a desirable benefit, the continuing escalation in premium costs places fiscal pressure on public agencies trying to maintain comprehensive health benefits. The GASB requirement to quantify and account for the long-term cost of these benefits will put further pressure on those agencies going forward. The provision of health benefits, particularly the prefunding of those benefits, must compete with other programs for limited fiscal resources.

1 Los Angeles Times, "Happenings on the Pacific Slope.", October 26, 1912, page 13

2 The term "safety" refers to those employees whose primary job duties are protecting the public's safety, including fire fighters, police, sheriffs, and other designated classifications.

3 The currently monthly employer contribution for active state employees varies depending on bargaining unit. In 2008, the lowest employer contributions will be \$321 (single), \$625 (two party), and \$807 (family). The highest are \$399, \$772, and \$994. The 2008 100/90 formula for retirees will be \$471, \$886, and \$1,129.

4 In most cases, the vesting schedules applicable to state employees do not include employees of the California State University, the judicial branch, or the Legislature.

5 National Survey of Employer-Sponsored Health Plans 2005, Mercer Consulting.

Appendix 2

Other Post-Employment Benefits: A Summary of GASB Statement No. 45

Note: This document was adapted from a plain-language summary prepared by the GASB staff (available at: http://www.gasb.org/project_pages/opeb_summary.pdf). Technical assistance was provided by John E. Bartel, President, Bartel Associates, LLC, whose actuarial work is primarily performed for California public sector entities.

On June 21, 2004, the Governmental Accounting Standards Board (GASB) approved Statement No. 45 (GASB 45), a new accounting standard for employer provided post-employment benefits other than pensions (OPEB). The goal of GASB 45 is to create greater financial statement accuracy by requiring benefits to be acknowledged at the time they are earned rather than when they are paid.¹

Initial Steps that an Employer Should Take to Comply with the New GASB Standards

In order to comply with the new GASB accounting standards for OPEB benefits, employers should take the following steps:

1. Begin by examining the benefits provided by the employer to identify whether they are OPEB benefits subject to the new GASB accounting standards. OPEB benefits include employer-sponsored and/or paid health care, dental, vision, life insurance, and long-term care.
2. After identifying OPEB benefits, summarize benefit promises by gathering information from MOUs, council or board resolutions, and other

sources. This information will help to facilitate the valuation process and the implementation of the new GASB standards.

Some questions to consider as a part of this information gathering process:

- Do retirees have access to any OPEB benefits in retirement?
 - If retirees have access to OPEB benefits, are they part of the employer's group risk pool? The employer should contact the various carriers to obtain the "implied subsidy" rates for both employees and retirees.
 - What are the conditions for retirees to have access to the employer's plans?
 - What are the conditions for the employer to provide contributions to retirees' OPEB benefits?
 - Are there differences between bargaining units? Management? Other participants?
 - What legal documents are available to establish the basis for OPEB benefits and conditions?
3. Gather OPEB plan participant data. Data collected for OPEB plan participants include:
- How many current retirees are receiving benefits?
 - How many deferred members may return at some point in the future to receive OPEB benefits?

- How many current employees are eligible to receive OPEB benefits?
 - What are the past and current premiums for retiree OPEB benefits? What is the employer's commitment?
4. Meet with an actuary to discuss the underlying actuarial methods and assumptions that will be used to account for and report OPEB liabilities. Questions that could be discussed as a part of this process include:
 - What are the assumptions that the actuarial study will use? (For example, what is the inflationary rate of health care? What is the investment return assumed on OPEB reserves?)
 - If they are different from the assumptions used for the defined benefit retirement plan, how are they different?
 5. After conducting an OPEB valuation, consider discussing the results with bond rating agencies, bargaining units, and city council (or other appropriate governing board).
 6. Begin to develop a plan to address OPEB liabilities. The employer should carefully consider all of the ramifications of OPEB benefits and liabilities before adopting a plan of implementation. These considerations include: prefunding strategies, continuance of OPEB benefits for future employees, and/or strategies which would eliminate GASB 43 & 45 responsibilities.

What Does GASB 45 Require?

As a result of GASB 45, public agencies will begin to reflect unfunded OPEB liabilities on their balance sheets which were previously unrecognized. The majority of public sector employers that provide OPEB benefits currently use a pay-as-you-go approach, meaning that benefits are paid as the premiums come due each year, with little or no money set aside to pay benefits in future years. GASB argues that pay-as-you-go funding of OPEB benefits shifts costs from one taxpayer generation to another, and reporting methods which do not include OPEB benefit costs as they accrue fail to provide an accurate picture of the full cost of providing government services.

Although OPEB benefits may not have the same legal standing as pensions in some jurisdictions, GASB believes that pension benefits (as a legal obligation) and OPEB benefits (as a constructive obligation in some cases) are a part of the compensation that employees earn each year, even though these benefits are not received until after employment has ended. Therefore, the cost of these future benefits is a part of the costs of providing public services today. However, most governments only report their cash outlays for OPEB benefits in a given year, rather than reporting employer costs of accrued OPEB benefits earned by employees in that year - and these two amounts may be vastly different.

Although the provisions of the new GASB standards do not require governments to prefund OPEB benefits, GASB 45 provides a framework for doing so.

What is the difference between GASB 43 and GASB 45?

GASB 43 applies to trusts which are established in order to prefund OPEB benefits and for trusts which are used as conduits to pay OPEB benefits. GASB 45 applies to the financial statements issued by employers which offer OPEB benefits.²

What Is the Governmental Accounting Standards Board (GASB)?

GASB is the private, nonpartisan, nonprofit organization that works to create and improve the rules U.S. state and local governments follow when accounting for their finances and reporting them to the public. GASB was founded in 1984 under the auspices of the Financial Accounting Foundation (the Foundation), which appoints GASB's board, raises its funds, and oversees its activities. The Foundation also oversees GASB's counterpart for private companies and not-for-profit organizations, the Financial Accounting Standards Board (FASB).

GASB reports that its mission is to establish and improve standards of state and local governmental accounting and financial reporting in a manner that will result in useful information for users of financial reports, and guide and educate the public, including issuers, auditors, and users of those financial reports.

Although there is no law requiring governments to comply with GASB, financial auditors will not certify that financial statements comply with generally accepted accounting principles (GAAP) unless the statements comply with GASB. The authority for its standards is recognized under the Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA), which requires auditors to note any departures from GASB standards when expressing an opinion on financial reports that are presented in conformity with GAAP. Also, legislation in many states requires compliance with GASB standards, and governments are usually expected to prepare financial statements in accordance with GASB when issuing bonds or other public debt instruments.

GASB is composed of a full-time chair and six part-time board members drawn from various parts of GASB's constituency—state and local government finance officers, auditors, accounting professionals, academics, and users of financial statement information. GASB has a professional staff that works directly with the board and its task forces, conducts research, analyzes oral and written comments received from the public, and drafts documents for consideration by the board.

How Does GASB Set Standards?

Before issuing standards, GASB follows a set of “due process” activities enumerated in its published rules of procedure. Due process is designed to permit timely, thorough, and open study of financial accounting and reporting issues by the preparers and users of financial reports in order to encourage broad public participation in the standards-setting process.

For many issues it addresses, GASB:

- Appoints an advisory task force of outside experts;
- Studies existing literature on the subject and conducts or commissions additional research if necessary;
- Publishes for public comment a discussion document setting forth the issues and possible solutions;
- Conducts public hearings; and
- Broadly distributes an Exposure Draft of a proposed standard for public comment.

Significant steps in the process are publicly noticed, and GASB's meetings are open to the public.

The board is also advised by the Governmental Accounting Standards Advisory Council, a 29-member group appointed by the Foundation and representing a wide range of GASB's constituents.

Additional information about GASB and its activities may be found at www.gasb.org.

What are Other Post-Employment Benefits and Why are They Important?

Employees of state and local governments may be compensated in a variety of forms in exchange for their services. In addition to a salary, many employees earn benefits that will not be received until after their employment with the government ends. In the public sector, the most common type of post-employment benefit is a pension. As the name suggests, other post-employment benefits (OPEB) are post-employment benefits other than pensions. OPEB benefits may include health, dental, and vision benefits provided to eligible retirees and beneficiaries. OPEB benefits may also include some types of life insurance, legal services, and other benefits.

What Types of OPEB Plans Do Governments Use?

Plans are often distinguished by how many employers participate in them. As the name indicates, single-employer plans involve only one employer or agency, whereas multiple-employer plans include more than one employer. If an employer establishes or sponsors a single-employer trust, the employer becomes responsible for complying with GASB 43 requirements.

In a cost-sharing multiple-employer plan, employers pool or share the costs of providing benefits and administering the plan. In such a plan, a single actuarial valuation is generally conducted for all of the employees of the participating governments combined. In agent multiple-employer plans, there is no pooling of benefit costs. Separate actuarial calculations are made for each participating employer in the plan, and separate accounts are maintained to ensure that each employer's contributions are used to provide benefits only for the employees of that employer. The cost of administering the plan, however, is shared by the participating employers.

How Do Governments Currently Finance Post-Employment Benefits?

In general, post-employment benefits are financed in one of two ways. Some employers follow a prefunding approach which entails paying to a pension plan or an OPEB trust an amount which is expected to be sufficient, if invested now, to finance the post-employment benefits of current employees. This is also the most commonly followed approach for funding public pensions.

For OPEB benefits, however, most employers currently follow a pay-as-you-go approach, paying an amount each year which is equal to the benefits distributed or claimed in that year. GASB 45 only requires the reporting of financial liabilities, it does not mandate the prefunding of OPEB benefits (in other words, to set aside assets in advance to pay benefits in the future).

Why has GASB Issued New Standards for OPEB Benefits?

GASB established standards in 1994 for the reporting of public employee pension benefits. Although OPEB benefits may have the same legal standing as pensions in some jurisdictions, similar reporting guidelines were not created for OPEB benefits. GASB 45 recognizes that pension and OPEB benefits are both part of the deferred compensation which employees earn while working, requiring the cost of these future benefits to be recognized as a cost of providing public services today. Before GASB 45, most governments did not report the full present value of OPEB benefits earned by their employees (as deferred compensation) each year.

When Should Governments Implement These New Standards?

Implementation of the new standards by employers is based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Governments with total annual revenues of \$100 million or more must implement the new standards for reporting periods after December 15, 2006.
- Governments with total annual revenues of \$10

million or more, but less than \$100 million must implement the new standards for reporting periods after December 15, 2007.

- Governments with total annual revenues of less than \$10 million must implement the new standards for reporting periods after December 15, 2008.

The GASB 43 standards for OPEB plans are effective one year prior to the implementation date for the employer (in a single-employer plan) or for the largest participating employer in the plan (for multiple-employer plans).

How Often Should Governments Account for OPEB Benefits?

In general, employers should account for and report the annual cost of OPEB benefits, and the outstanding obligations and commitments related to OPEB benefits, in the same manner as for pensions. These amounts should be produced by actuarial valuations performed in accordance with parameters established by GASB and accepted actuarial practices set forth by the Actuarial Standards Board. The frequency of actuarial valuations is determined by the total number of plan members (active employees, separated employees with vested benefits, and retirees). Valuations should be conducted at least every two years if the plan has 200 or more members and at least every three years for plans with fewer than 200 members.

How Should Governments Determine the Cost of OPEB Benefits?

The process of determining how much should be set aside now in order to provide for future benefits requires the use of actuarial methods and assumptions. An actuary's estimate or "valuation" is the product of many assumptions based on historical experience regarding factors which will determine the level of resources needed in the future to pay for benefits. These factors include, but are not limited to:

- How many employees will be eligible to receive benefits;
- How long employees are expected to work for the employer;

- How long employees are expected to live after retiring (and, hence, how many years they will receive benefits);
- How much health care costs are expected to increase; and
- How large a return an employer is expected to receive on investments.

The actuary calculates how much should be contributed annually to ensure that an adequate amount of money will be available in the future to pay for the promised benefits. Using methods described in the actuarial assumptions Appendix of this report, the actuary will determine the present value of those future benefits. Using one of six acceptable actuarial cost methods, the actuary spreads the cost of the actuarial present value over a period which approximates the anticipated number of years an average employee will work for the employer. The portion of the actuarial present value allocated to a particular year is called the normal cost.

The OPEB Liability

Actuarial calculations are required to take into account not only benefits expected to be earned by employees in the future (future normal costs), but also those benefits the employees have already earned. The portion of the actuarial present value allocated to prior years of employment—and thus not provided for by future normal costs—is called the actuarial accrued liability (AAL). In other words, the AAL represents the value of OPEB benefits earned by employees and retirees up to the date of the valuation. If an employer has assets in an OPEB trust, the actuarial value of those assets can be used to offset the AAL. If the actuarial value of assets is deducted from the AAL amount, the result is the unfunded liability (unfunded actuarial accrued liability or UAAL). The UAAL is typically amortized over a fixed period of time so the employer can make annual contributions toward reducing the UAAL.

OPEB Contributions

Together, the normal cost and the portion of the UAAL amortized in the current period make up the annual required contribution (ARC) of the employer. The ARC must be actuarially determined in accordance with the requirements of Statement 45. If paid in full on an ongoing basis, the ARC would be expected to provide sufficient resources to fund

both the normal cost for each year and the amortized unfunded liability. Employer contributions consist of payments directly to or on behalf of a retiree or beneficiary, premium payments to insurers, or irrevocably transferred assets to a trust (or equivalent arrangement) in which plan assets are dedicated to providing benefits to retirees and beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer and plan administrator.

OPEB Expenses, Expenditures, and the Net Obligations

For an employer in a single-employer or agent multiple-employer plan, the annual OPEB cost equals the ARC plus or minus adjustments if the employer's actual contributions in prior years differed from the ARC. The annual OPEB cost is the OPEB expense that a government would report in its accrual-based financial statements. Generally, the cumulative sum of the differences between an employer's annual OPEB cost and the amounts actually contributed to the plan makes up a liability (or asset) called the net OPEB obligation.

By contrast, for an employer participating in a cost-sharing multiple-employer plan, the annual OPEB expense is equal to the employer's contractually required contribution to the plan—the amount assessed by the plan for the period—which may or may not equal the ARC.

In financial statements using accrual accounting, a government is not required to place an initial liability on the statement of net assets when this standard is first implemented. Employers may report as a liability the accumulated differences between their actual contributions and the ARC for prior years to the extent they have the necessary information to do so.

Under modified accrual accounting in the governmental fund financial statements, an employer would report OPEB expenditures equal to the amount contributed to the plan or expected to be liquidated with expendable available financial resources. Because the governmental fund financial statements focus on current financial resources, they would not include the net OPEB obligation or any other long-term liability.

Implicit Rate Subsidies for Retirees

In health plans where retirees and active employees

are covered under the same risk pool, the premiums paid by the retirees are often lower than they would have been if the retirees were insured separately. The amount of the difference in retiree rates is called an implicit rate subsidy. Even if retirees pay 100 percent of premiums without a specific contribution from the employer, the employer still must determine the amount of the implicit rate subsidy and include it as an OPEB liability.

Provisions for Small Plans

As mentioned above, actuarial valuations are required at least once every two or three years, depending on the size of the employer and/or OPEB plan. In recognition of the potential cost of hiring consultants to perform these valuations, the standards allow the smallest single-employer plans—those with fewer than one hundred members—to estimate the AAL and the ARC using simplified methods and assumptions. (The method also is available to certain employers in agent multiple-employer plans.) The specifics of this alternative measurement method are described fully in Statements 43 and 45.

What Additional OPEB Information Should a Government Employer Present in its Financial Report?

Notes to the Financial Statements

To assist users in understanding the nature of an employer's OPEB benefits and its efforts to finance its OPEB liabilities, GASB's standards require governments to prepare note disclosures to accompany the expense, expenditure, and liability information reported in the financial statements.

Plan Description

An employer must disclose the following basic information about the types of OPEB benefits offered, how they are administered, and a description of the plan.

1. Name of the plan, identification of the public employee retirement system or other entity that administers the plan, and identification of the plan as a single-employer, agent multiple-employer, or cost-sharing multiple-employer defined benefit OPEB plan.
2. Brief description of the types of benefits and the authority under which benefit provisions are

established or may be amended. For example, the disclosure might reveal that a plan provides retirement, disability, and death benefits to plan members and their beneficiaries, and that a specific section of state law regulates the changing of benefit provisions.

3. Whether the OPEB plan issues a stand-alone financial report or is included in the report of a public employee retirement system or another entity and, if so, how to obtain the report.

Funding Policy

Employers should disclose the following funding policy information about how contributions are made toward financing OPEB benefits:

1. Authority (for example, state statute) under which the obligations of the plan members, employer(s), and other contributing entities (for example, state contributions to local government plans) to contribute to the plan are established or may be amended.
2. Required contribution rate(s)—if any—of active plan members.
3. Required contribution rate(s) of the employer—if any—in accordance with the funding policy, in dollars or as a percentage of current-year payroll. If the plan is a single-employer or agent plan and the rate differs significantly from the ARC, an employer should disclose how the rate is determined. If the plan is a cost-sharing plan, an employer should disclose the required contributions in dollars, the percentage of that amount contributed for the current year and each of the two preceding years, and how the required contribution rate is determined. Employers should also disclose any legal or contractual limitations on the maximum amount of their contributions.
4. A brief description of any long-term contracts for plan contributions and the amount still outstanding; for example, an employer which is not able to make its full contribution in a given year might agree with the plan to make up the shortfall with interest in annual installments over a three-year period.

Members and Types of Benefits

If an employer includes an OPEB plan in its financial statements as a trust or agency fund and the plan

does not issue its own financial statements separate from those of the employer, the employer also discloses the following information about the plan as a whole:

1. The types of employees covered (such as general employees, police officers, legislators) and, for multiple-employer plans, the participating governments.
2. The number of members, sorted by (1) retirees and beneficiaries currently receiving benefits, (2) members no longer working for the government and entitled to benefits, but not yet receiving them, and (3) current employees.
3. A brief description of (1) the types of benefits provided and (2) provisions for cost-of-living adjustments or other future increases in benefits.
4. The balances remaining as of the date of the financial report in the plan's legally required reserves, a description of the purpose of the reserves, and whether the reserves are fully funded.

Costs and Obligations, Methods and Assumptions

Because employers participating in single-employer or agent multiple-employer plans are individually responsible for financing the OPEB cost of their own employees and retirees, these governments are required to provide additional information in their notes. The following additional disclosures are intended to help users assess whether the employers are keeping pace with actuarially required contribution amounts, the extent to which the resources set aside for paying OPEB benefits are sufficient or insufficient, and the methods and assumptions employed to conduct the actuarial calculations:

1. For the current year, annual OPEB cost and the dollar amount of contributions actually made. If the employer has a net OPEB obligation, it should also disclose the components of annual OPEB cost, the increase or decrease in the net OPEB obligation, and the net OPEB obligation at the end of the year.
2. For the current year and each of the two preceding years, annual OPEB cost, percentage of annual OPEB cost contributed that year, and net OPEB obligation at the end of each year.
3. The funded status of the plan; this is the same information governments would be required

to disclose in a schedule of funding progress (see below), but only for the most recent valuation date.

4. Information about actuarial methods and assumptions used in the valuations which determined the ARC, annual OPEB cost, the funded status, and the funding progress of OPEB plans. (More details regarding this information can be found in Statement 45.)

Required Supplementary Information (RSI)

Employers generally should present RSI related to defined benefit OPEB plans covering the last three actuarial valuations. An employer participating in a cost-sharing multiple-employer plan, however, does not have to present RSI for OPEB benefits as long as the plan issues its own separate financial report or is included in the financial report of another governmental entity.

Three types of RSI about defined benefit OPEB plans might be presented in a government's financial report: (1) schedule of funding progress; (2) schedule of employer contributions; and (3) notes to the RSI schedules.

The schedule of funding progress provides information that is useful for judging how well funded a pension plan is. The schedule of employer contributions compares a government's actual contributions to its OPEB plan with its ARC. If an employer is aware of any factors that have a significant effect on the trend information in the two RSI schedules, such as improvements or reductions in OPEB benefit provisions, expansion or reduction of the eligible population, or changes in the actuarial methods, it should add an explanatory note to the schedules.

Employers in single-employer and agent multiple-employer plans should present funding progress information pertinent to the employer's own members. If an employer includes the OPEB plan in its financial statements as a trust fund and a separate report is not issued by the OPEB plan, then the employer generally would present additional RSI:

1. An employer in a single-employer plan would add a schedule of employer contributions.
2. An employer in an agent plan would present a schedule of funding progress and a schedule of employer contributions for the agent plan as a whole (in addition to the schedule of funding

progress the employer is already presenting for just its own employees and retirees).

3. An employer in a cost-sharing plan would present a schedule of funding progress and a schedule of employer contributions for the cost-sharing plan as a whole.

What Information Should an OPEB Plan Present in its Financial Report?

Financial Statements

GASB 43 requires the financial report of a defined benefit OPEB plan includes two financial statements:

1. The statement of plan net assets includes information about the plan's assets, liabilities, and net assets as of the end of the fiscal year.
2. The statement of changes in plan net assets provides information about additions to, deductions from, and net increases or decreases in plan net assets during the fiscal year. Additions generally include employer and member contributions and investment income. Deductions typically are benefits and administrative expenses.

Notes to the Financial Statements

Defined benefit OPEB plans should prepare note disclosures to give users information about plan description, accounting policies, contributions, reserves, funded status, and funding progress.

Plan Description

An OPEB plan should include the following information to inform the user about the nature of the plan, its members, and the OPEB benefits it provides:

1. Identification of the plan as a single-employer, agent multiple-employer, or cost-sharing multiple-employer defined benefit OPEB plan and disclosure of the number of participating employers and other contributing entities.
2. Classes of employees covered (for example, general employees and public safety employees) and information on the current members, including the number of retirees and beneficiaries currently receiving benefits, terminated members entitled to but not yet receiving benefits, and current active members.
3. Brief description of benefit provisions.

Accounting Policies

In its summary of significant accounting policies, a plan should disclose the accounting choices it has made, including:

1. Basis of accounting, including the policy with respect to recognition in the financial statements of contributions, benefits paid, and refunds paid.
2. Brief description of how the fair value of investments is determined.

Contributions and Reserves

The following information should be disclosed to help users understand how contributions are made to the plan, as well as the amounts and purposes of the plan's reserves:

1. Authority under which the obligations of the plan members, employer(s), and other contributing entities to contribute to the plan are established or may be amended.
2. Funding policy, including a brief description of how the contributions of the plan members, employer(s), and other contributing entities are determined, how the costs of administering the plan are financed, and any legal or contractual maximum contribution rates.
3. Required contribution rates of active plan members, in accordance with the funding policy.
4. Brief description of the terms of any long-term contracts for contributions to the plan and disclosure of the amounts outstanding at the reporting date.
5. The balances in the plan's legally required reserves at the reporting date, as well as a brief description of the purpose of each reserve and whether the reserve is fully funded.

Funded Status and Funding Progress

Finally, plans should prepare a note disclosing the most recent information about their funded status and funding progress:

1. The funded status of the plan as of the most recent valuation date.
2. Disclosure of information about actuarial methods and assumptions used in the valuations which determined the ARC, annual OPEB cost, the funded status, and funding progress. (More

details regarding this information can be found in Statement 43.)

Required Supplementary Information

Following the notes, plans should present two schedules with required supplementary information. The schedule of funding progress shows historical trend information about the funded status of the plan and efforts to accumulate sufficient resources to pay benefits when they come due. (This historical trend information should be based on the past three actuarial valuations. It will cover a period as short as three fiscal years, if the valuation is conducted annually, or as long as nine years if the valuation is performed every three years.) The disclosure should include the actuarial valuation date, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded actuarial accrued liability, the

actuarial value of assets as a percentage of the actuarial accrued liability (funded ratio), the annual covered payroll, and the ratio of the unfunded actuarial accrued liability to annual covered payroll.

To help users understand whether government contributions are keeping pace with amounts required by the actuarial calculations, the schedule of employer contributions should present historical trend information comparing the ARC with actual employer contributions for the fiscal years covered by the three most recent actuarial valuations. This should include the dollar amount of the ARC applicable to each year and the percentage of the ARC that was recognized as employer contributions in the plan's "statement of changes in plan net assets" for each year.

1 "The Not So Golden Years: Credit Implications of GASB 45," by Joseph D. Mason, Amy S. Doppelt, Amy R. Laskey, and David T. Litvack, Fitch Ratings, June 22, 2005.

2 "GASB 45 – Frequently Asked Questions," Milliman, <http://www.milliman.com/expertise/employee-benefits/services/gasb45/faqs.php>

How to Read an Actuarial Valuation

The California Public Employee Post-Employment Benefits Commission is charged with the task of identifying the full amount of pension, retiree health, and other post-employment benefits (OPEB) “for which California governments are liable and which remain unfunded,” as well as evaluating and proposing solutions for addressing this unfunded liability. Because unfunded liability is an actuarial concept, a thorough understanding of the issues before the Commission requires at least a basic knowledge of actuarial methods and terminology. For this reason, the Commission and its staff developed the following overview of actuarial methods and practices that are part of conducting a valuation. This overview is intended to be a resource for public agencies, public retirement systems and other parties interested in learning more about public pensions and OPEB benefits.

What Is an Actuary? An actuary is a professional who analyzes the financial consequence of risk. Actuaries use mathematics, statistics, and financial theory to study uncertain future events, particularly those of concern to insurance and pension programs.

Pension actuaries, for example, analyze probabilities related to the demographics of pension plan members (e.g., the likelihood of retirement, disability, and death) and economic factors that may affect the value of benefits or the value of assets held in a pension plan’s trust (e.g., investment return rate, inflation rate, and rate of salary increases). They determine the value of pension benefits and work with employers to devise strategies for funding the cost of the

benefits. In California, retirement system boards have the responsibility to set actuarial methods and assumptions and to determine contribution policy, while the actuary’s job is to make recommendations to the board in these areas.

What Is an Actuarial Valuation? An actuarial valuation can be thought of as a financial check-up for a pension or retiree medical plan. It measures current costs and contribution requirements to determine how much employers and employees should contribute to maintain appropriate benefit funding progress based on various economic and demographic assumptions. It also measures plan assets and liabilities to determine current funding progress. This includes comparing recent plan experience with assumptions made in the previous valuation.

Actuarial reports vary in format, but most follow a similar structure. The information is often shown in three parts of the report.

- The summary usually includes text descriptions and numerical tables of the important results.
- The body of the report usually contains more details on the results and an explanation of how they were determined.
- Exhibits or appendices are often used for summaries of benefits and assumptions, required disclosure information, member demographic information, and more detailed contribution information.

The valuation report presents both what goes into the valuation and the results that come out of it.

What Goes Into an Actuarial Valuation? A valuation takes into consideration a range of factors that affect the funding progress of the plan including:*

- Plan provisions
- Participant data
- Financial data
- Economic actuarial assumptions
- Demographic actuarial assumptions
- Funding methods and policies

What Comes Out? An actuarial valuation yields information about:

- **Contribution Requirements:** The amount of contributions that will be necessary to pay for the costs of current benefits (the normal cost) as well as the costs of any unfunded liability (benefits that have already accrued but for which the plan does not have sufficient assets to pay). Note that in the accounting standards for both pensions and OPEB benefits, the sum of the normal cost plus the annual payment on any unfunded liability is called the annual required contribution or ARC.
- **Funding Progress:** An analysis of how the assets held by the plan compare to the benefits that have accrued.

In addition, the “actuarial balance sheet” is included in many actuarial reports as an overview of the long-term funding of the system. It looks at the total present value of future benefits† (PVB) both in terms of to whom it will get paid and from where the funding will come.

Primary Purposes of an Actuarial Valuation

Contribution Requirements

The primary purpose of a valuation is to enable decision makers to determine how much employers

and employees should contribute to the plan during the upcoming year. Public employees typically contribute a fixed percentage of their salaries to a defined benefit plan. Annual changes in contribution rates generally affect only the employer contribution.

Usually there is a lag between the valuation date and the date new contribution rates begin. For example, the June 30, 2007 actuarial valuation might be used to set contribution rates for the 2008/09 fiscal year, starting July 1, 2008.

Funding Progress

The second key purpose of a valuation is to determine the plan’s funding progress by examining how the plan’s assets compare with its liabilities. The funding progress can be described as a funded ratio (assets divided by liabilities) or as the funded status, which is the amount of over-funding or under-funding (assets minus liabilities).

If assets are greater than liabilities:

- The funded ratio is over 100%. For example, if a plan’s Actuarial Accrued Liability equals \$100 million and plan assets equal \$106 million, then the funded ratio equals 106% (\$106 million/\$100 million).
- The funded status is the amount of over-funding and is called the “surplus.” For the above example, the surplus would equal \$6 million.

If assets are less than liabilities:

- The funded ratio is under 100%. For example, if a plan’s Actuarial Accrued Liability equals \$100 million and plan assets equals \$95 million, then the funded ratio equals 95% (\$95 million/\$100 million).
- The funded status is the amount of under-funding and is called the “unfunded liability” or, more formally, the “unfunded actuarial accrued liability” (UAAL). For the above example, the UAAL would equal \$5 million.

* See the Actuarial Assumptions section later in this document for a full description of these factors.

† Present Value of Future Benefits (PVB)—A measure of the total plan liability or obligation for benefits due to past and future service for current employees (active participants), terminated participants not yet retired, retired participants and beneficiaries.

Actuarial Certification

A third key purpose is to get the actuary's professional opinion on the actuarial methods and assumptions and the funding policy. In California, retirement system boards have the responsibility to set actuarial methods and assumptions and to determine contribution policy, while the actuary's job is to make recommendations to the board in these areas. The retirement system board is not required to take the actuary's recommendations, but the actuary must certify that what the board has decided falls within a range of acceptable actuarial standards of practice.

Secondary Purposes of an Actuarial Valuation

Disclosure Requirements

Accounting and other financial reporting rules require disclosure of the plan's annual required contribution, plan assets and liabilities, as well as other information. Disclosure is required for both employer and plan financial statements.

Basis for Pricing Plan Changes

The actuarial valuation provides the baseline for evaluating the impact of any possible benefit changes on plan costs and plan liabilities.

Analysis of Demographic Experience

The actuarial valuation provides summary information about plan membership including age, service, and salary for actives and the age and benefit amounts for retirees.

Analysis of Financial Experience

The actuarial valuation provides a summary of plan asset information including an income statement and balance sheet, although not as detailed as the plan's audited financial statements.

The Basic Funding Equation: $C + I = B + E$

Contributions plus investment returns equal benefits plus expenses. This equation provides the foundation for understanding how prefunded pension (or OPEB benefit) plans are funded. Employer and employee contributions flow into a trust fund that is dedicated for the purpose of paying benefits. Those contributions earn investment returns. Benefits and

expenses (associated with administering the benefits and investing the assets) are paid out of the fund. Any increase in benefits or expenses will ultimately require a corresponding increase in contributions or investment returns.

The actuarial assumptions and funding policies adopted by the plan determine how and when the costs are paid, and changes in those assumptions or policies can increase or decrease the current contribution requirements. However, it is important to remember that the ultimate cost of the plan will depend on the plan's actual experience, regardless of what was assumed would happen.

Actuarial valuations can also assist decision makers in efforts to achieve equity across generations of taxpayers by funding the employees' benefits while they are rendering service, so that the cost of the benefits is incurred by the taxpayers receiving services from those employees. The goal is that, at retirement, there will be enough money, on a present value basis, to pay for the entire benefit. Another advantage of prefunding is that over time the majority of benefit costs are paid by investment returns rather than by contributions from the employer or employees. For example, in the last decade, approximately 75% of pension benefits paid by CalPERS were funded by investment returns.¹

The actuary's role is to help the retirement boards balance the equation by developing a long-term contribution plan necessary to pay expenses and benefits. As noted above, actuarial assumptions, methods, and funding policies may affect the timing of when and how the long-term benefit costs are paid. By choosing accurate actuarial assumptions and level funding methods and policies, a retirement system strives to have stable, level contributions over time.

Despite the apparent simplicity of the funding equation, pension actuaries' task of balancing the equation can be complex. Describing what he refers to as the "tenuous nature of actuarial science," CalPERS Chief Actuary, Ron Seeling, explains that the role of the pension actuary is to make long-term assumptions about an unknown future:

You hire some new employee at age twenty-something, and you've got to worry about when is this person going to leave? What will I owe them? How much service will they have? What will their salary be?... [You] make

*assumptions about all of that. And you do these studies, and you make your best assumption about the future. And the fact that it doesn't work out on a year-by-year basis is no great surprise. And the question is, how is the actuary going to respond to that and change employers' contributions?*²

Indeed, how the actuary and the retirement board respond can have a significant impact on funding progress and future contributions. Beyond the uncertainty associated with predicting the future, additional complexity stems from the fact that retirement systems may pursue varying funding objectives. While some may strive to keep contributions as low as possible or as steady as possible, others might place a greater emphasis on working toward full funding as quickly as possible. These objectives impact actuaries' recommendations to retirement system boards, as well as the assumptions and funding policies adopted by those boards.

Actuarial Methods and Funding Policies

The actuarial report will include a summary of actuarial methods and funding policies that have been adopted by the system. The methods and policies are developed by actuaries and adopted by policy makers to do two things:

- Determine how much of the total value of the members' future benefits should be contributed each year by both the employer and the members.
- Determine the employer contribution in a way that reduces short-term, year-to-year volatility,

but still assures that future contributions, together with plan assets, will be enough to provide those future benefits.

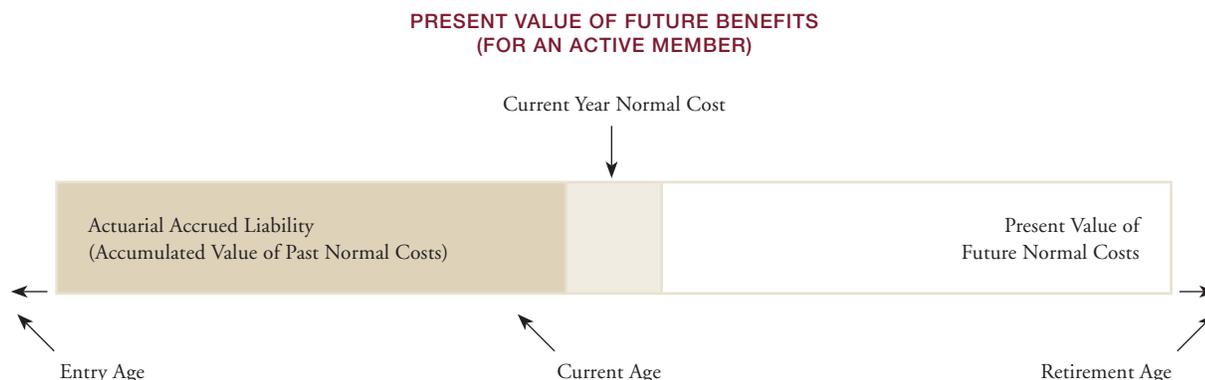
In other words, plan provisions, participant data, and actuarial assumptions determine the total present value of future benefits (PVB). If the system has assets equal to the PVB (and all assumptions come true!) then no additional contributions would be needed to provide future benefits for current active and retired members—even taking into account future service and salary increases for active members. The actuarial methods and funding policies determine how much of the PVB should be contributed in the current year (and future years) so that, together with the assets, the entire PVB will be funded.

Actuarial methods and funding policies involve terminology and concepts that are unique to pension plan funding. What follows is a brief description of the three main types of methods and policies, including some of the key terminology.

Actuarial Cost Method

Also referred to as the actuarial funding method, the actuarial cost method allocates a portion of the total present value of future benefits (PVB) to each year of service, both past and future.

The portion allocated to a year of active member service is the normal cost for that year. The **normal cost** is the basis for all the contribution and liability results in the valuation. It is the portion of the long-term cost allocated to a single year of service. It can be thought of as the annual premium that the must be contributed to fund the benefit in the absence of any surplus or unfunded liability. If the normal cost



is paid during each year of service and all actuarial assumptions are met, the employee's pension benefit will be fully funded at the time of retirement.

The **actuarial accrued liability (AAL)** is the value today of all past normal costs. For retired members, all normal costs are in the past so their AAL is the entire value of their benefit (PVB). For active members, the AAL can be thought of as the amount of assets the system would have today if:

- The current plan provisions, participant data, and actuarial assumptions had always been in effect;
- In each past year, contributions equaled the normal cost for that year; and
- In each past year, all the actuarial assumptions had come true.

Asset Smoothing Method

Actuaries assign a market-related value to a plan's assets in order to determine contribution requirements. This value is called the actuarial value of assets (AVA) or, more commonly, the "smoothed value" of assets. In order to minimize short term, year-to-year contribution rate fluctuations, actuarial policies typically require the plan's investment gains and losses to be spread, or "smoothed," over a period of time. The objectives of the AVA are to:

- Track the market value of assets over time;
- Smooth out short-term fluctuations in market values; and
- Produce a smoother pattern of contributions than would result from using the market value.

For example, suppose a plan with a five-year smoothing period experiences a 10% gain (an increase over the expected return) in the market value of its assets in a given year. That plan will spread that gain over a period of five years, recognizing only a 2% increase in the current year's AVA for that gain. The remaining 8% gain will be included in the AVA over the next four years.

Amortization Policy

When actuarial assumptions are not met, the plan may fall behind (or get ahead of) its funding schedule. Plan assets may become insufficient to cover liabilities, requiring employers to come up with additional funds to pay for the shortfall.

The unfunded actuarial accrued liability (UAAL) is the amount (if any) by which the actuarial accrued liability (AAL) exceeds the actuarial value of assets (AVA), while the surplus is the amount (if any) by which the AVA exceeds the AAL.

- When a plan has a shortfall of assets compared to liabilities (a UAAL), the current contribution includes the normal cost plus a charge to fund, or "amortize," the shortfall.
- When a plan has an excess of asset over liabilities (a surplus), the current contribution includes the normal cost minus a credit to amortize the excess.

A plan's amortization policy determines how to either fund or take credit for any difference between liabilities and assets (the UAAL or surplus). "Amortize" generally means to pay off an obligation through a series of payments. A plan's amortization policy determines how much of the UAAL will be funded each year or how much of the surplus will be used up. Amortization policies vary in terms of length and also in terms of whether there is one amortization period for the entire UAAL or separate amortization periods for different parts of the UAAL (for example, a benefit improvement and investment losses being amortized on separate schedules).

When a plan has an unfunded liability, a shorter amortization period is generally considered to be a more conservative approach. Contributions will be higher than they would be with a longer amortization period, but the shortfall will be paid and the contributions will revert down to just the normal cost more quickly.

In contrast, when a plan has a surplus, a longer amortization period is more conservative. As CalPERS Chief Actuary notes that when a plan has a surplus, a shorter amortization period is no longer conservative:

Our prior funding methods at CalPERS had what anybody would call very conservative mathematical and actuarial practices. We amortized investment gains and losses over about ten years... We spread asset gains and losses over three years...And in a situation where you have an unfunded liability, that's going to really hurry up and get you back to 100% quickly, which is where we started. Now, witness the incredible stock-market boom of the late 1990s. And everything that was an*

unfunded liability turned into plus, and now you're giving surplus back to the employers through reduced contributions over three-year periods, and it resulted in 75% of all CalPERS employers contributing zero. So what was really conservative approaches, "let's hurry up and pay off unfunded liabilities," completely backfires.³

* 3 year asset smoothing

The Required Contribution

Using methods and policies described above, actuaries determine the current year normal cost and the portion of the cost of unfunded liabilities that need to be paid each year. These two elements of the PVB constitute the current year contribution and are represented by the two slices that extend out from *Chart 1* shown here.

In *Chart 1*, the two shaded sections taken together represent the value of the actuarial accrued liability (AAL). The portion of the AAL that is funded by current assets is the actuarial value of assets (AVA). The difference between the AAL and the AVA is the unfunded actuarial accrued liability (UAAL). The

CHART 1:
The Many Parts of the Current Year Contribution

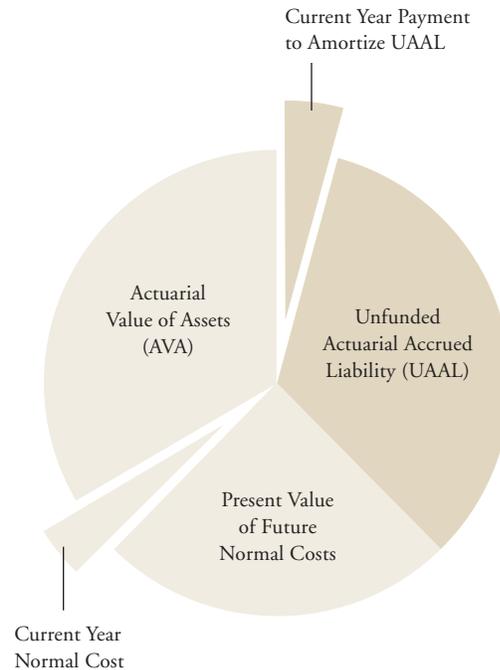


TABLE 1:
Sample Schedule of Funding Progress (In millions)

ACTUARIAL VALUATION DATE	(1) ACTUARIAL VALUE OF ASSETS	(2) AAL *	(3) UAAL † (2) - (1)	(4) FUNDED RATIOS (1) / (2)	(5) ANNUAL COVERED PAYROLL	(6) UAAL AS A % OF COVERED PAYROLL (3)/(5)
6/30/1996	\$94,230	\$96,838	\$2,608	97.3%	\$22,322	11.7%
6/30/1997	\$108,566	\$97,925	(\$10,641)	110.9%	\$22,504	(47.3%)
6/30/1998	\$128,830	\$106,938	(\$21,892)	120.5%	\$24,672	(88.7%)
6/30/1999	\$148,605	\$115,748	(\$32,857)	128.4%	\$27,636	(118.9%)
6/30/2000	\$162,439	\$135,970	(\$26,469)	119.5%	\$28,098	(94.2%)
6/30/2001	\$166,860	\$149,155	(\$17,705)	111.9%	\$30,802	(57.5%)
6/30/2002	\$156,067	\$163,961	\$7,894	95.2%	\$32,873	24.0%
6/30/2003	\$158,596	\$180,922	\$22,326	87.7%	\$34,784	64.2%
6/30/2004	\$169,899	\$194,609	\$24,710	87.3%	\$35,078	70.4%
6/30/2005	\$183,680	\$210,301	\$26,621	87.3%	\$36,045	73.9%

* Actuarial Accrued Liability.

† Unfunded Actuarial Accrued Liability. Negative amount indicates an excess of assets over liabilities.

white portion of *Chart 1* represents the costs that will be paid for the future service of current members.

How to Read a Plan's Schedule of Funding Progress

One of the elements of an actuarial valuation is a schedule of funding progress. This is typically a table that displays the value of the plan's assets and liabilities over time. It also shows a plan's funding progress as the ratio of assets to accrued liabilities expressed as a percentage (funded ratio). When assets exceed liabilities, the ratio is greater than 100%. When assets are less than accrued liabilities, the ratio is less than 100%.

The sample schedule of funding progress (*Table 1*) presents key actuarial figures for CalPERS' valuations conducted for ten separate years. The valuations for the years 1997 through 2002 reflect significant investment earnings that resulted in a surplus (i.e., a negative value for UAAL) and funded ratios greater than 100%.

CalPERS' data was used for this sample schedule of funding progress for no other reason than that it was readily available. The reader should note that the system's Public Employees' Retirement Fund has experienced double digit investment returns (well above the assumed rate of return) annually since 2004. CalPERS officials announced in July 2007 that most of their plans were 100% funded on a market-value basis.⁴

Actuarial Assumptions and Other Elements That Go into a Valuation

Contribution requirements and funding progress are the end results of a valuation. Those results are dependent on a number of elements that go into the valuation, including crucial information about the plan, actuarial assumptions, and actuarial methods and policies.

Information about the Plan

Plan Provisions

The actuarial report will include a summary of benefit provisions. This can be a handy reference, but it should be used carefully, as it is not an official plan summary. Any discrepancies between this summary

and the actual benefits should be reported to the actuary. In particular, it is always good to make sure that recent plan changes are reflected in the summary of benefit provisions.

Participant Data

The actuarial report will include various summaries of member data. There are three categories of members: actives, retirees (including beneficiaries), and members who have terminated with a deferred vested benefit (also sometimes known as inactive members). The membership data is reviewed by an actuary for reasonableness, but the actuary does not "audit" the data by comparing it to other data sources (payroll, etc.). This means the data will not be perfect but that any data flaws are expected to result in only minor differences in valuation results.

Open vs. Closed Valuations

Almost all public sector systems determine contributions (this will almost certainly be true for OPEB plans as well) using a closed group valuation. This means the valuation does not predict future hires. In addition, almost all public sector retirement systems determine contributions as a percent of payroll (contribution rate. (This will also likely be true for OPEB plans.) When an agency makes a contribution, they determine the dollar contribution by applying the contribution rate to payroll, including new hires. This means that an agency is making a contribution for people hired after the valuation date.

It is also important to understand that future hires do not impact a plan's funded status. The funded status is a comparison between assets available and the Actuarial Accrued Liability (AAL). Since new entrants have no prior service, they have no impact on either assets or the AAL.

Financial Data

The actuarial report will include summaries of plan assets and related calculations. This is usually obtained from the retirement system or from an outside auditor. All systems report market value, and some still use book value or cost value as part of their calculations. From the market value information, the actuary determines the "actuarial value" that is used in the valuation. The valuation report will show how the actuarial value of assets is determined.

Actuarial Assumptions

The actuarial report will include a summary of actuarial assumptions. These include both demographic assumptions about plan members as well as economic assumptions. The system actuary will recommend assumptions, but ultimately, the selection of the assumptions is made by the governing board of the retirement system. The assumptions selected have an impact on the timing of contributions and the funding status of the plan. The more closely the adopted assumptions match the future, the more accurate the determination of the plan's real costs and funding status.

Demographic Assumptions

Demographic assumptions determine when and for how long members will receive the various types of benefits. The main demographic assumptions are rates (probabilities) of “decrement,” i.e., what percentage of members at each age will die (mortality), retire, become disabled, or withdraw/terminate.

Mortality

Mortality assumptions can vary by type of member and sometimes by cause of death. In particular, there can be different mortality assumptions for:

- death before and after retirement;
- service connected death and non-service connected death; and
- service retirees, disabled retirees, and beneficiaries.

Retirement

Retirement assumptions are generally based on age, but can also depend on years of service. Often there will be higher retirement rates assumed for members eligible for an unreduced retirement benefit, based either on service or on some combination of age and service.

Disability

Disability assumptions can vary by type of disability, i.e., whether the disability is job-related and whether it is a total and permanent disability.

Withdrawal/Termination

Actuaries make assumptions about members who withdraw from the system by withdrawing their member contributions and those who terminate after

becoming vested, leave their contributions with the system and thereby have a deferred vested benefit. Termination rates can depend on age, service, or a combination of both.

Other Demographic Assumptions

Actuaries also make assumptions about other demographic factors that impact anticipated benefits including:

- Percent of active members married or with domestic partners (and thus eligible for survivor benefits);
- Member/spouse age difference for active members; and
- Percent of deferred vested members who are working in a reciprocal system.

Economic Assumptions

Economic actuarial assumptions predict how the assets and benefits grow over time. The key economic assumptions are investment earnings, salary increases, and inflation. Because the three are related—inflation, for example, affects both investment earnings and salary increases—the assumptions should be kept consistent with one another.

Investment Earnings

Investment earnings affect how much of future benefit payments can be funded by investment income rather than by contributions. The assumed rate of return is composed of several components, including inflation, the real rate of investment return, and administrative and investment expenses.

What happens if the assumed rate of return is lowered? Recall that the basic funding equation for employee benefit trusts says that contributions plus investment earnings equal benefits and expenses. If lower investment earnings are anticipated, current contributions must increase to make up the expected difference. Put another way, when trustees lower the investment return assumption they are saying that the current assets on hand are not expected to earn as much as previously thought, and thus, will not fund as large a portion of plan liabilities (i.e., the portion of the present value of benefits attributed to the past).

For the 126 retirement systems included in the 2006 National Association of Retirement System Administrator's Public Fund Survey, investment

return assumptions ranged from 6% to 8.5% with a mean of about 8%.⁵ CalSTRS uses an 8% investment return assumption; CalPERS uses 7.75%; while the two 37 Act retirement systems for Los Angeles and Alameda Counties use 7.75% and 7.8%, respectively.

Salary Increases

The salary increase is typically composed of three components including inflation, real salary increases (after inflation is taken into account), and increases based on merit and promotion. A plan that raises its salary increase assumption expects to pay higher benefits. This is because employees' salaries are a factor in determining the amount of pension benefits. A higher rate of salary increase means that benefits will be higher and more money will be needed to pay for those benefits. This will increase contributions and liabilities.

In an actuarial valuation, a projection of "total payroll" usually includes inflation and real salary increases, but not the merit and promotion increases, which are increases that individual members receive as they advance in their careers. Because assumptions about merit and promotion increases are based on the specific experience of the system, this assumption is often studied along with the demographic assumptions.

Inflation

Inflation affects cost of living adjustments (COLAs) and is also a component of both investment earnings and salary increases. Lowering the inflation assumption decreases the investment return, which causes contributions to go up and the funded ratio to go down. At the same time, however, a decrease in the inflation assumption causes a corresponding decrease in the salary increase rate. This causes the contribution rate to decrease and the funded ratio to increase.

In a typical plan, investment earnings have a significantly greater impact than salary increases. Required contributions will rise to a greater extent due to a lower investment return rate than they will fall due to a lower salary increase rate. This means that, on the whole and assuming no other assumption components are changed, a decrease in the inflation assumption causes contribution rates to increase.

Health Care Inflation

An OPEB plan valuation includes one significant actuarial assumption that is not included in a pension plan valuation: health care inflation. This is a crucial assumption for any OPEB plan where the benefit is based on the actual cost of health care (as opposed to some fixed dollar formula). Frequently, there will be different health care inflation assumptions for different types of coverage (medical, vision, dental, etc.) and also for different types of provider arrangements (indemnity plan, PPO, HMO, etc.).

Health care inflation assumptions, especially for medical coverage, generally start at fairly high levels (often over 10% per year) and then trend downward over five to ten years to an "ultimate" level, usually around 5%. The starting assumptions reflect current levels of medical inflation, which are much higher than overall price inflation. The assumptions decrease in the future, since health care inflation cannot continue indefinitely to be higher than the growth of the overall economy.

The logic behind this assumption is that health care today is approximately 15% of the Gross Domestic Product (GDP) and this percentage is increasing. Most economists believe there is a limit to the amount this percentage can increase, saying that the limit is approximately 20+%. If health care costs continue to increase above 10% with general inflation less than 4%, then health care as a percentage of the GDP will, become much greater than 20+%. The decrease in the healthcare trend to 5% or so is designed to recognize this limitation. However, because there is no way to really know when health care inflation will actually reduce to this ultimate level, this assumption is usually reviewed frequently.

For many OPEB plans, differences between actual and expected health care growth and changes in the health care assumption will likely generate quite a bit of OPEB actuarial liability and, perhaps, ARC volatility.

Conclusion

Actuarial work for pension and OPEB benefit trusts can be compared to steering a ship across a sea. You set a course based on your knowledge of existing

conditions. As winds and currents change, it may become necessary to change course in order to arrive at the desired port. Without accurate data about current conditions, periodic review, and a sound plan for how to act on the data, errors can compound over time and put the ship far off course.

This analogy has several implications for actuarial work intended to guide pension and OPEB benefit trusts toward the destination of full funding:

- Due to the interrelationship of actuarial factors (inflation, for example, affects both investment returns and salary increases) errors can compound to significantly affect the outcome of actuarial forecasts. Actuarial assumptions must therefore be

realistic and based on accurate data about member demographics and economic conditions.

- Actuarial studies should be repeated at regular intervals to determine whether assumptions need to be changed.
- Finally, staying on course requires governing boards of pension and OPEB benefit trusts to develop and adhere to funding policies which are based on sound actuarial methods, while resisting temptations to alter amortization periods, actuarial assumptions, or asset valuation methods for the purpose of lowering costs in the short-term if those changes would work to the detriment of the long-term funding plan.

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- 1 Testimony of Jason Dickerson, Principal Fiscal and Policy Analyst, California Legislative Analyst's Office. California Public Employee Post-Employment Benefits Commission Meeting, Rancho Cucamonga, CA, May 31, 2007: pp. 76-7. <http://www.pebc.ca.gov/images/files/Minutes-053107.pdf>
 - 2 Testimony of Ron Seeling, Chief Actuary, California Public Employees' Retirement System. California Public Employee Post-Employment Benefits Commission Meeting, Burlingame, CA, July 12, 2007: pp. 125-6. <http://www.pebc.ca.gov/images/files/Minutes-071207.pdf>
 - 3 Testimony of Ron Seeling, Chief Actuary, California Public Employees' Retirement System. California Public Employee Post-Employment Benefits Commission Meeting, Burlingame, CA, July 12, 2007; pp. 132-3. <http://www.pebc.ca.gov/images/files/Minutes-071207.pdf>
 - 4 Testimony of Ron Seeling, Chief Actuary, California Public Employees' Retirement System. California Public Employee Post-Employment Benefits Commission Meeting, Burlingame, CA, July 12, 2007: pp. 139. <http://www.pebc.ca.gov/images/files/Minutes-071207.pdf>
 - 5 2006 Public Fund Survey, National Association of State Retirement System Administrators, 2007. <http://www.publicfundsurvey.org>

Appendix 4

Summary of Actuarial Assumptions and Methods in Use in California's Public Sector

This Appendix section presents current actuarial assumptions and methods used by several public retirement systems in California. This summary is provided for informational purposes only and is intended to illustrate the range of actuarial assumptions in use in California's public sector.

All information is based on reports from the most recent actuarial valuation for each retirement system. For additional background on actuarial methods, please consult the "How to Read an Actuarial Valuation" section of this report.

ASSUMPTION	ACERA	CALSTRS	CALPERS PUBLIC AGENCIES	CALPERS SCHOOLS & STATE	CCCERA
Methods:					
• Funding method ¹	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
• Most recent valuation date	December 31, 2006	June 30, 2006	June 30, 2006	June 30, 2006	December 31, 2006
• Contribution due on the fiscal year beginning ²	6 months after valuation date	Contribution rates fixed by statute	2 years after valuation date	1 year after valuation date	18 months after valuation date
• Asset valuation method	5 year smoothing 80%/120% Corridor ³	3 year smoothing	15 year smoothing 80%/120% Corridor	15 year smoothing 80%/120% Corridor	5 year smoothing
• Amortization method	Level % of pay	Level % of pay	Level % of pay	Level % of pay	Level % of pay
• Amortization period					
Restarted amortization or single period amortization	26 years [declining]				16 years [declining]
Plan changes ⁴		30 years (rolling)		20 years	
Assumption / method changes ⁴		30 years (rolling)	20 years	20 years	
Gains/losses ⁴		30 years (rolling)	30 years [rolling]	30 years [rolling]	

Explanation of funding method terms: **1** Entry Age Normal – Funding method where the cost of benefits is allocated evenly (as a percent of payroll or level dollar amount) over the participants' working lifetime. Under this method the cost of benefits in the current year is the same percentage of payroll or dollar amount as for other years. Projected Unit Credit – Funding method where the benefits are allocated evenly over the participants' working lifetime. Under this method the benefits allocated in the current year are equal to the projected benefits at retirement divided by total service at

Retirement Systems

ACERA	Alameda County Employees' Retirement Association
CalSTRS	California State Teachers' Retirement System
CalPERS	California Public Employees' Retirement System
CCCERA	Contra Costa County Employees' Retirement Association
LACERA	Los Angeles County Employees' Retirement Association
LACERS	Los Angeles City Employees' Retirement System
LAFPP	City of Los Angeles Fire and Police Pension Plan
OCERS	Orange County Employees' Retirement System
SCERS	Sacramento County Employees' Retirement System
SDCERA	San Diego County Employees' Retirement Association
SFERS	San Francisco Employees' Retirement System

	LACERA	LACERS	LAFPP	OCERS	SCERS	SDCERA	SFERS
	Entry Age Normal	Projected Unit Credit	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
	June 30, 2006	June 30, 2007	June 30, 2007	December 31, 2006	June 30, 2007	June 30, 2007	June 30, 2006
	1 year after valuation date	1 year after valuation date	1 year after valuation date	18 months after valuation date	1 year after valuation date	1 year after valuation date	1 year after valuation date
	3 year smoothing	5 year smoothing 80%/120% Corridor	5 year smoothing 80%/120% Corridor	5 year smoothing	5 year smoothing 80%/120% Corridor	5 year smoothing	5 year smoothing
	Level % of pay	Level % of pay	Tier 1: Level \$ Other Tiers: Level % of pay	Level % of pay	Level % of pay	Level % of pay	Level % of pay
	30 years [rolling]			26 years [declining]	26 years [declining]	20 years [declining]	
		30 years	30 years				20 years
		30 years	30 years				15 years
		15 years	15 years	15 years			15 years

retirement. **2** Contribution typically paid throughout fiscal year. **3** 80%/120% Corridor with Smoothing – Asset valuation method where the actuarial value of assets gradually reflects market fluctuations but can not differ from the actual market value of assets by more than 20%. **4** Declining from year incurred unless otherwise noted.

ASSUMPTION	ACERA	CALSTRS	CALPERS PUBLIC AGENCIES	CALPERS SCHOOLS & STATES	CCCERA
Economic Assumptions:					
• Investment return					
General inflation (CPI)	3.75%	3.25%	3.00%	3.00%	3.75%
Real rate of return (above inflation)	4.25%	4.75%	4.75%	4.75%	4.05%
Investment earnings (discount/interest) rate	8.00%	8.00%	7.75%	7.75%	7.80%
• Salary					
Real across the board increase ⁵	0.25%	1.00%	0.25%	0.25%	0.50%
Aggregate (overall) payroll growth ⁶	4.00%	4.25%	3.25%	3.25%	4.25%
Individual salary increases (including inflation) ⁷	General: 4.73%–7.68% Safety: 4.26%–7.61% [age based]	.5%–5.6% [entry age, and service based]	Misc.: 3.25%–14.45% Safety: 3.25%–13.15% [entry age and service based]	3.25%- 19.95% [entry age, service and plan based]	General: 5.00%–11.75% Safety: 5.00%–12.25% [service based]
• Cost of living increases	2.00%–3.00% [tier based]	2% (simple)	2%–5%, limited to general inflation	2%–3%, limited to general inflation	3.0%–3.75% [tier based]
Demographic Assumptions ⁸:					
• Mortality ⁹					
Pre-retirement	1994 GAM Table	Experience study based on age and gender	Experience study based on age and gender – Separate rates for Misc. & Safety	Experience study based on age, gender and plan	RP-2000 set back 2 years
Post-retirement					
Healthy (Not Disabled)	1994 GAM Table	Experience study based on age and gender	Experience study based on age and gender – Same rates for Misc. & Safety	Experience study based on age and gender	RP-2000 set back 2 years
Disabled	General: 1981 Disability Table set back 7 years Safety: 1981 Disability Table set back 2 years	1994 GAM by gender with 3 year select rates	Experience study based on age and gender – Same rates for Misc. & Safety	Experience study based on age and gender	General: RP-2000 set forward 6 years Safety: RP-2000
• Retirement:					
Service	Experience study based on age and tier – Separate rates for General & Safety	Experience study based on age, gender and years of service	Experience study based on age, gender and years of service – Separate rates for Misc. & Safety	Experience study based on age, years of service and plan	Experience study based on age and tier – Separate rates for General & Safety

⁵ Real Salary Increase – Across the board annual salary increase before inflation. ⁶ Aggregate Payroll Growth – Annual increase in payroll due to inflation and real salary increase. ⁷ Individual Salary Increases – Annual salary increases due to longevity, merit, across the board real increase and inflation. ⁸ All retirement systems base demographic assumptions (including anticipated individual salary increases) on experience. ⁹ All retirement systems, except CalPERS, use standard mortality tables, selecting those tables based on experience.

LACERA	LACERS	LAFPP	OCERS	SCERS	SDCERA	SFERS
3.50%	3.75%	3.75%	3.50%	3.500%	3.75%	3.50%
4.25%	4.25%	4.25%	4.25%	4.375%	4.50%	4.50%
7.75%	8.00%	8.00%	7.75%	7.875%	8.25%	8.00%
0.25%	0.25%		0.00%	0.25%	0.50%	1.00%
3.75%	4.00%		3.50%	3.75%	4.25%	4.50%
4.01%–9.98% [service based]	< 5yrs. Service: 6.75%–10.0% > 5yrs. Service: 4.75%–6.75%	4.90%–10.09% [age based]	General: 4.10%–10.50% Safety: 3.50%–9.50% [age based]	Misc: 5.14%–11.55% Safety: 3.75%–9.76% [age based]	> 5 yrs.: 5.25% < 5 yrs: separate rates for General & Safety 6.25%–11.75%	General: 3.50%–16.50% Safety: 4.50%–24.50% [service based]
2%–3% maximum, [inflation and tier based]	3.00%	3.00%–3.75% [tier based]	3.00% maximum, [inflation based]	0.00%–3.40% [Misc./Safety and tier based]	3.00%	2–4.5% [based on Misc./ Safety & Old/New plan]
General: RP-2000 set back 2 years Safety: RP-2000 set back 3 years (males), 2 years (females)	1994 GAM Table	RP-2000 set back 2 years	1994 GAM Table set forward 1 year	1994 GAM Table set back 1 year	1994 GAM Table	1994 GAM Table
General: RP-2000 set back 2 years Safety: RP-2000 set back 3 years (males), 2 years (females)	1994 GAM Table	RP-2000 set back 2 years	1994 GAM Table set forward 1 year	1994 GAM Table set back 1 year	General: 1994 GAM Table Safety: 1994 GAM Table set back 1 year	1994 GAM Table
General: RP-2000 set forward 3 years (males), 1 year (females) Safety: RP-2000 (males), set forward 3 years (females)	1994 GAM Table set forward 8 years	RP-2000 set forward 1 year	1994 GAM Table set forward 5 years	Miscellaneous: 1981 Disability Table set back 3 years Safety: 1994 GAM Table set back 1 year	General: 1994 GAM Table set forward 7 years Safety: 1994 GAM Table set back 1 year	1994 GAM Table
Experience study based on age, gender and tier – Separate rates for General & Safety	Experience study based on age	Experience study based on age and tier – Separate rates for Fire & Police	Experience study – Separate rates for General & Safety	Experience study based on tier – Separate rates for Misc. & Safety	Experience study – Separate rates for General & Safety	Experience study – Separate rates for General & Safety

Explanation of mortality assumption terms: Group Annuity Mortality (GAM) Table RP-2000 – Mortality table prescribed by the IRS for certain pension plans. **Set back** – Each participant is considered to have a life expectancy of a younger individual. **Set forward** – Each participant is considered to have a life expectancy of an older individual.

ASSUMPTION	ACERA	CALSTRS	CALPERS PUBLIC AGENCIES	CALPERS SCHOOLS & STATES	CCCERA	
Demographic Assumptions (Continued):						
Disability	Experience study – Separate rates for General & Safety	Experience study based on age, gender, entry age and disability program	Experience study based on age and gender – Separate rates for Misc. & Safety	Experience study based on age, gender and plan	Experience study based on tier for General, None for Safety	
• Termination	Experience study based on age and years of service – Separate rates for General & Safety	Experience study based on entry age, gender and years of service	Experience study based on entry age and years of service – Separate rates for Misc. & Safety	Experience study based on entry age, years of service and plan	Experience study based on age and years of service – Separate rates for General & Safety	
• Percent married	Males 80% Females 55%	Males 90% Females 70%	Misc. 85% Safety 90%	85%–90% [plan based]	Males 80% Females 55%	
• Spouse's age	Females 3 years younger than males	Females 3 years younger than males	Females 3 years younger than males	Females 3 years younger than males	Females 3 years younger than males	

	LACERA	LACERS	LAFPP	OCERS	SCERS	SDCERA	SFERS
	Experience study based on age, gender and tier – Separate rates for General & Safety	Experience study	Experience study – Separate rates for Fire & Police	Experience study – Separate rates for General & Safety	Experience study – Separate rates for Misc. & Safety	Experience study based on age and gender – Separate rates for General & Safety	Experience study based on age and gender – Separate rates for General & Safety
	Experience study based on age, gender and tier – Separate rates for General & Safety	Experience study based on age and years of service	Experience study based on age and years of service – Separate rates for Fire & Police	Experience study based on age and years of service – Separate rates for General & Safety	Experience study based on age and years of service – Separate rates for Misc. & Safety	Experience study based on age, gender and years of service – Separate rates for General & Safety	Experience study based on age, gender and years of service – Separate rates for General & Safety
	Males 82% Females 65%	Males 76% Females 50%	86%	Males 80% Females 50%	Males 80% Females 55%	Males 80% Females 55%	Males 80–90% Females 42–48% [based on Misc./ Safety & Old/New plan]
	Females 4 years younger than males	Females 4 years younger than males	Females 3 years younger than males	Females 4 years younger than males	Females 3 years younger than males	Females 3 years younger than males	Females 3 years younger than males

Appendix 5

Summary of OPEB Funding Options

Note: The following discussion on OPEB funding was developed by Robert A. Blum, Hanson Bridgett Marcus Vlahos & Rudy, LLP, San Francisco, CA

This appendix section summarizes and compares the options under federal income tax rules for holding assets to fund health benefits for retirees (called “OPEB benefits” below), where the assets are held solely for the benefit of the participants and beneficiaries and can be used only to provide OPEB benefits. It also includes the option of a rabbi trust. Options such as 457 plans, 403(b) plans, and 401(a) plans are not discussed because they would provide a taxable retirement benefit that can be used for any purpose, including OPEB benefits. For a more thorough comparison of these options, refer to the chart at the end of this section. Any of these options can be used to hold assets in a “pooled account” or for “individual accounts.”

A. Options

The tax effective options for funding OPEB benefits include:

- A trust under Section 115 of the Internal Revenue Code (115 trust)
- A trust that is an “integral part” of the agency for federal tax purposes (integral part trust)
- A trust that is a voluntary employee beneficiary association (VEBA)
- An account that is part of a retirement system or part of a 401(a) plan in some circumstances (401(h) account)
- A rabbi trust

Each option has pros and cons and should be chosen based on the objectives of the public agency.

1. 115 Trust

Under Internal Revenue Code (IRC) Section 115, assets to fund OPEB benefits may be held in a tax-exempt trust that is treated as wholly separate from the agency. Generally, no income is taxable to the trust because it is derived from the exercise of an essential function of and accruing to a political subdivision of a state.

Assets can be held solely for the benefit of members and beneficiaries, so a 115 trust can be structured to meet GASB rules.

There is little regulation or guidance by the IRS of a 115 trust. Due to limited guidance in the tax rules, there is some uncertainty about the operation of 115 trusts. However, a 115 trust generally does not take a long time to establish, and no IRS ruling is required for its tax exemption. The IRS will generally rule on these trusts, if asked.

If organized properly, the same type of investments that are available to pension trusts under California law should be available to a 115 trust, but assets in a 115 trust cannot be commingled for investment with pension assets.

There appear to be no tax rules on the governance structure of a 115 trust. Under state law, the trust should be administered consistent with the rules for pension systems in order to allow the trustees to invest broadly. If these rules are followed, it is also likely that the general fiduciary rules of Proposition 162 will govern the actions of the trustees and/or managers of the 115 trust.

There are no restrictions on the amount of assets contributed to the trust, as long as the assets are used for the intended purpose. It appears that MOUs can provide for mandatory (pre-tax) member contributions. It should be possible to have voluntary after-tax member contributions, but the limits on this are not well defined.

2. Integral Part Trust

This trust is considered to be an “integral part” of the government agency for tax purposes. Therefore, as a Constitutional matter, it is not subject to federal taxation. This trust can hold assets to fund OPEB benefits in the same way as a 115 trust, so it also should be available to meet the GASB rules.

There is less guidance from the IRS on the tax rules for an integral part trust than for a 115 trust, but the guidance indicates the integral part trust only works for a single employer trust. The required governance structure is not clear, and the amount of after-tax contributions that can be made is also unclear. As of this writing, the IRS would not issue rulings on integral part trusts because the Justice Department has asked that no new rulings be issued while certain litigation is pending.

Investments under an integral part trust should be the same as under a 115 trust, as long as its governance structure can be established to fit within Proposition 162. Assets in an integral part trust cannot be commingled for investment with pension assets.

There appear to be no restrictions on the amount of assets contributed to the trust, as long as the assets are used for the intended purpose.

3. VEBA

A VEBA is tax-exempt under IRC Section 501(c)(9), which is the current version of a tax statute originally enacted over 60 years ago. Originally, a VEBA was a voluntary association of employees who came together to provide group-based welfare benefits. Assets held by a VEBA must be held solely for the benefit of members and beneficiaries, so a VEBA should meet the GASB rules.

The IRS has issued a number of regulations that govern VEBAs. The most important is that a VEBA cannot be tax-exempt unless there is a timely application to the IRS and the IRS agrees that it is exempt. Additionally, an annual tax

return must be filed for a VEBA. Further, there are “nondiscrimination” rules that must be met. Special favorable rules apply if the VEBA is maintained for employees covered by collective bargaining.

If organized properly, the same type of investments that are available to pension trusts under California law should be available under a VEBA, but assets in a VEBA cannot be commingled for investment with pension assets.

The IRS rules also regulate the governance structure of a VEBA although the rules are not wholly clear. A joint labor/management board is acceptable but may not be required as long as fiduciary rules such as those established for California public retirement systems control the governance. Also, an independent third-party bank trustee is acceptable.

4. 401(h) Account

Under IRC Section 401(h), a retirement system and certain types of 401(a) plans can hold assets to pay retiree medical benefits. Because the system is tax-exempt, the 401(h) account is also tax-exempt. Assets held in a 401(h) account are held for the exclusive benefit of members and beneficiaries, so this account should meet the GASB rules. The account is managed by the governing body of the retirement system.

There are a number of IRS regulations that govern a 401(h) account, including restrictions on the amount of contributions that can be made to the account. Generally, no more than 1/3 of the total employer contributions in any year can be to this account, not taking into account contributions for past service. Therefore, if the annual required contribution to the system is reduced because of a positive experience like investment gains, the amount that can be contributed to the 401(h) account will also generally be reduced.

Assets held in a 401(h) account are commingled with the pension assets for investment.

5. Rabbi Trust

A rabbi trust does not meet GASB rules because the assets are not held solely for the exclusive benefit of members and beneficiaries. Generally, if the agency goes bankrupt or gets into another similar financial situation, creditors of the agency can take assets from this type of trust.

A rabbi trust is included in this memorandum because some believe that even though trust assets

will not reduce an OPEB liability under GASB rules, as a practical matter, the assets will be reported on the agency's balance sheet and those assets should counterbalance any OPEB liability for purposes of overall financial reporting.

The income of a rabbi trust is tax-exempt because it is treated as income of the agency.

There is a risk that the investments of a rabbi trust can only include the same investments that the agency itself can make directly under the limitations of the California Constitution on investments by public agencies, because a rabbi trust cannot be organized to meet the requirements of Proposition 162.

There are no tax limits on the governance structure of a rabbi trust.

A rabbi trust can be established very quickly and at relatively low cost because the IRS has provided a model trust for this purpose.

6. Combination

Some agencies may wish to consider a combination of different types of trusts.

TABLE: Side-by-Side Comparison of OPEB Funding Options

This chart summarizes the options under federal income tax rules for holding assets to fund OPEB benefits for retirees, where the assets are held solely for the benefit of the participants and beneficiaries and can be used only to provide retiree health benefits. The chart also discusses the option of a rabbi trust. Options such as 457 plans, 403(b) plans, and 401(a) plans are not discussed because they would provide a taxable retirement benefit that can be used for any purpose, including OPEB benefits.

FACTORS	RABBI TRUST	SECTION 115 TRUST	INTEGRAL PART TRUST	VEBA	SECTION 401(h) ACCOUNT—PART OF RETIREMENT SYSTEM [OR CERTAIN 401(a) PLANS]
DESCRIPTION					
1. Description of the option	<p>Assets to fund retiree health benefits (called “OPEB benefits” in this chart) are held in a trust that, for tax purposes, is treated as an extension of the employer. Therefore, no income of the trust is taxable to the trust.</p> <p>The assets of the trust are not held solely for the benefit of participants and beneficiaries, and under some circumstances, the agency’s creditors may be able to reach the assets of the trust. These circumstances must be stated in the trust document.</p>	<p>Assets to fund OPEB benefits are held in a trust that is treated as wholly separate from the agency. Generally no income is taxable to the trust because the income on trust assets is treated as tax-exempt under Section 115 of the Internal Revenue Code (IRC), which governs income derived from the exercise of an essential function of and accruing to a political subdivision of a state.</p> <p>The assets of the trust would be held solely for the benefit of participants and beneficiaries and the creditors of the agency generally should not be able to reach the assets.</p>	<p>Assets to fund OPEB benefits are held in a trust that is treated as wholly separate from the agency for purposes of use of the assets, but is treated as part of the agency for tax purposes. Generally no income is taxable to the trust; the income on trust assets is treated as tax-exempt under the Constitution.</p> <p>The assets of the trust would be held solely for the benefit of participants and beneficiaries, and the creditors of the agency generally should not be able to reach the assets.</p>	<p>Assets to fund OPEB benefits are held in a trust that is treated as wholly separate from the agency. Generally no income is taxable to the trust because the trust is tax-exempt under IRC Section 501(c)(9) governing VEBAs.</p> <p>The assets of the trust would be held solely for the benefit of participants and beneficiaries, and the creditors of the agency generally should not be able to reach the assets.</p>	<p>Assets to fund OPEB benefits are held in a separate account that is part of the retirement system. Generally no income is taxable to the trust because all income earned on retirement system assets is tax-exempt under the qualified retirement plan rules.</p> <p>The assets of the trust would be held solely for the benefit of participants and beneficiaries, and the creditors of the agency generally should not be able to reach the assets.</p>
SECURITY					
2. Asset security	<p>Assets are secure to pay the benefits owed unless and until the agency goes into bankruptcy or similar situations (or unless the agency designs the plan so the assets can be used for other purposes).</p> <p>The assets in a rabbi trust will not reduce GASB liability because they can be used for purposes other than paying OPEB benefits. However, because these assets would be reported on the books of the agency, some believe that as a practical matter they would have a financial effect similar to that of a direct reduction of GASB liability.</p>	<p>Assets generally are secure to pay the benefits owed because they can only be used for the benefit of participants and beneficiaries. However, there may be some uncertainty about protection from creditors.</p>	Same as prior column	Same as prior column	Same as prior column

FACTORS	RABBI TRUST	SECTION 115 TRUST	INTEGRAL PART TRUST	VEBA	SECTION 401(h) ACCOUNT—PART OF RETIREMENT SYSTEM [OR CERTAIN 401(a) PLANS]
TAXES					
3. Tax certainty	Highly certain; the rules are well understood. Treated as part of the agency, so tax-exempt to the same extent as the agency.	Recently the IRS has been willing to issue rulings on the tax-exempt status of OPEB trusts established under Section 115. (However, there has been some inconsistency between the rulings of different branches of the IRS especially where there are individual participant accounts.)	Less certain because recently the IRS has said that they would not issue “integral part” rulings. The reason is that the Dept of Justice has asked that no new rulings be issued while certain litigation is pending.	The rules are well set out, though as with many tax laws, there are uncertainties because of complexity.	Same as prior column
4. Tax on trust on income earned?	No	No, as long as no unrelated business taxable income (UBTI). It is not certain that the UBTI tax rules apply here, but this is essentially irrelevant if there are no leveraged investments.	There is a better case here than for 115 trusts that UBTI does not apply. Otherwise, same as prior column.	UBTI may apply. Otherwise, tax exempt.	Same as prior column
5. Retiree health benefits can be paid tax-free to employees, surviving spouses, and tax dependents?	Yes. However, if benefits are not fully insured, they may be taxable to “highly compensated individuals” (HCI’s) if the plan discriminates in favor of HCI’s.	Yes; Same as prior column	Yes; Same as prior column	Yes; Same as prior column	Yes; Same as prior column
6. Retiree health benefits can be paid to domestic partners on a taxable basis if not tax dependents?	Yes, but IRS’ current position is that OPEB benefits are earned by the employee during employment, and the value is taxable income when earned by the employee. This is very difficult to administer.	Same as prior column	Same as prior column	Same as prior column	Same as prior column
7. Tax regulation of the trust	Effectively no tax regulation of consequence. As long as the rabbi trust rules are met, the benefits and administration are subject to MOU and plan documents.	Effectively no tax regulation of consequence except for possible restrictions on “self insured” plans (see below). As long as the 115 trust rules are met, the benefits are subject to MOU and plan documents.	Effectively no tax regulation of consequence except for possible restrictions on employee accounts (see below) and other self insured plans.	There are tax rules regarding: (1) non-discrimination of benefits provided, (2) amounts of funding, (3) holding assets for the exclusive benefit of participants, (4) the use of surplus assets, (5) governance, and (6) other issues. These issues usually will not cause problems for the agency, though it is important to properly comply with the tax laws.	There are tax rules regarding: (1) the amount of contributions in any one year (see below), (2) accounting for assets, (3) the use of “surplus” assets on termination, and (4) other similar issues. There appear to be no “non-discrimination” rules for the trust itself.

FACTORS	RABBI TRUST	SECTION 115 TRUST	INTEGRAL PART TRUST	VEBA	SECTION 401(h) ACCOUNT—PART OF RETIREMENT SYSTEM [OR CERTAIN 401(a) PLANS]
TAXES CONTINUED					
8. IRS approval required	No, and the IRS will rarely rule on a rabbi trust because they have provided a standard form document.	No, though the agency might want to consider a ruling, as discussed above.	We understand that currently the IRS will not rule on these trusts.	Yes, a VEBA cannot be tax-exempt without an IRS ruling.	No. Many public agencies do not have a tax ruling on the tax status of a retirement system, though this may be changing.
9. Annual tax returns required?	No	No	No	Yes, Form 990 is required. This can be an important consideration because agencies are not accustomed to filing federal tax returns.	No
UP AND RUNNING QUICKLY					
10. Speed/ease of establishing	Can be established quickly. The IRS has issued a standardized trust document that can be copied and modified as needed.	A custom plan and trust document must be created, though forms exist. The trust can be funded and benefits begun before an IRS ruling is obtained. One or more vendors may offer this type of trust.	Same as prior column	Same as prior column	A custom plan and 401(h) account document must be created. The method of establishing a 401(h) account depends on the law governing the retirement system. For example, the rules are different for CalPERS and '37 Act systems.
BENEFITS PAYABLE					
11. Type of benefits payable	Whatever is in the governing plan documents.	Under the tax rules, "welfare" benefits provided in the governing plan. However, to meet the "funded" rules, GASB may require that only OPEB benefits can be provided.	Same as prior column	Same as in prior column, but subject to VEBA rules. For example, there cannot be any discrimination in favor of highly paid employees. The IRS may treat as "discrimination" benefits that are better for longer-service employees and most likely will treat as discriminatory benefits that are related to compensation levels.	Only retiree health benefits can be provided.
CONTRIBUTION LIMITS					
12. Limits on contributions	No tax limit.	Generally, no tax limit.	Same as prior column	Same as prior column	Limit generally is no more than 1/3 of pension contributions (excluding contributions for past service cost) with a carryover for unused amounts from the date the account is established.

FACTORS	RABBI TRUST	SECTION 115 TRUST	INTEGRAL PART TRUST	VEBA	SECTION 401(h) ACCOUNT—PART OF RETIREMENT SYSTEM [OR CERTAIN 401(a) PLANS]
GOVERNANCE, ADMINISTRATION, INVESTMENTS AND RESPONSIBILITY					
13. Third-party administrators if desired?	Yes	Yes	Yes	Yes	Retirement system administers the benefit, but could outsource to third-party administrator.
14. Investments available	Whatever is available under California law. Notwithstanding Gov. Code Section 53620, there is a risk that Article XVI, Section 6 of the Constitution prohibits investment in equities.	Whatever is available under California law. Some have questioned whether an OPEB trust may invest in equities, notwithstanding Gov. Code Section 53620, unless structured to fit within Article XVI, Section 17 of the Constitution.	Same as prior column	Same as prior column	Assets are commingled with retirement system assets for investment. Note that commingling cannot occur under the tax laws for the other types of trust.
15. Investment responsibility	Responsibility is determined by the governing documents.	Determined by governing document. For example: board of trustees, agency treasurer, investment manager, or bank trustee. See below regarding responsibility.	Same as prior column	Same as prior column	Determined by retirement system.
16. Fiduciary responsibility	Unclear. There is a possibility that no trust-type fiduciary rules apply because the assets could be considered to be part of the agency's assets. A more prudent approach would be to apply general fiduciary rules and to build them into the governing trust document.	May be able to delegate some fiduciary responsibility for investments from the trust's governing board to an investment manager or other person/entity. Most likely the governing board will retain responsibility for the choice of the investment manager or other responsible entity, and must periodically review this choice.	Same as prior column	Same as prior column	Board of retirement has responsibility to same extent as for pension investments.
17. Applicable fiduciary rules	See response to number 16 above	California law, as applicable, and the terms of any trust and plan documents. "Exclusive benefit" rules will also be imposed by the trust document in order to meet GASB funding rules. As noted above, it may be best to structure the trust so it fits within Article XVI, Section 17 of the Constitution (Prop. 162) for investment flexibility.	Same as prior column	Same as prior column	Prop 162 applies.

FACTORS	RABBI TRUST	SECTION 115 TRUST	INTEGRAL PART TRUST	VEBA	SECTION 401(h) ACCOUNT—PART OF RETIREMENT SYSTEM [OR CERTAIN 401(a) PLANS]
GOVERNANCE, ADMINISTRATION, INVESTMENTS AND RESPONSIBILITY CONT.					
18. Agency may control and have responsibility for operations?	Yes	Yes. There is no tax requirement for employee control or participation in administration. However, assets must be held for the exclusive benefit of the participants and beneficiaries to meet the GASB rules.	IRS requires that the agency exert significant influence over the trust. This is often done by retaining the power to amend, terminate, and direct daily operations. However, assets must be held for the exclusive benefit of the participants and beneficiaries to meet the GASB rules.	The VEBA regulations require that, to be tax-exempt, a VEBA must be “controlled” by its membership. VEBAs that are subject to ERISA reporting and fiduciary rules automatically meet this requirement. Otherwise, one of three rules must be met: (1) control by the membership; (2) control by an independent trustee; or (3) control by trustees of whom some are selected by the membership (no explicit number or percentage is set out in the rules). This rule has not been tested in the public employer environment. The IRS has informally indicated that in the right circumstance, the governance rules for an ERISA-covered VEBA may apply to a public sector VEBA.	Retirement system has control and responsibility.
19. Trustee holds assets?	Yes	Yes	Yes	Yes	Yes
DEALING WITH CHANGE					
20. Ability to change/ terminate (flexibility to adapt to changing circumstances)	Subject only to MOU and terms of the plan and trust documents.	Subject to MOU and terms of the plan and trust documents, and also subject to the GASB “exclusive benefit” limits.	Same as prior column	Assets can only be used for employee welfare benefits. For example, additional welfare benefits such as life, disability, or vacation can be paid from a VEBA. It is possible that there would be more limits on the use of VEBA assets than the other options in the case of national health insurance funded by taxing the employer and employee.	Assets can only be used for retiree health benefits. On satisfaction of all health care liabilities, assets must revert to the employer. So in the case of national health insurance funded by taxes, assets in this fund may have to revert to the employer. Perhaps the employer could make an agreement that plan assets would be used in whole or in part for the benefit of the employees.

FACTORS	RABBI TRUST	SECTION 115 TRUST	INTEGRAL PART TRUST	VEBA	SECTION 401(h) ACCOUNT—PART OF RETIREMENT SYSTEM [OR CERTAIN 401(a) PLANS]
DEALING WITH CHANGE CONT.					
21. Ability to allow employees to contribute to an individual account to supplement the agency provided benefits, with contributions (pre-tax) required of each member of a bargaining unit	Problematic because assets are subject to claims of the agency's creditors.	Should be OK for union employees.	Should be OK for union employees.	Should be OK for union employees.	Should be OK for union employees. Additional Section 415 limits may apply.
22. Ability to allow employees to voluntarily contribute (after-tax) on an individual basis to an account to supplement the agency provided benefits	Problematic because assets are subject to claims of the agency's creditors. Also, this might be a security subject to federal and state regulation.	Probably OK.	There are uncertain limits on the amount of after-tax employee contributions.	After-tax voluntary contributions should be OK, though there is little guidance on this issue.	After-tax contributions should be OK, subject to retirement system approval. Additional Section 415 limits apply.
23. Ability to allow employees to voluntarily contribute (pre-tax) on an individual basis to an account to supplement the agency provided benefits	No	No. Pre-tax voluntary contributions are strongly opposed by the IRS.	Same as prior column.	Same as prior column.	It might be possible for contributions to be pre-tax, though the IRS would be very unhappy with this and certainly would challenge it. Additional Section 415 limits may apply.

Appendix 6

Executive Summary, Gabriel, Roeder, Smith and Company (GRS) Report to the State Controller

This appendix section provides the Executive Summary of the May 7, 2007 actuarial valuation determining the GASB 45 OPEB liability of the State of California.

The complete report is available on the State Controller's website at: http://www.sco.ca.gov/eo/pressbox/2007/05/OPEB_actuaria_report.pdf

EXECUTIVE SUMMARY

Other Postemployment Benefits

Sponsored by the
State of California

As of July 1, 2007

Introduction

The Governmental Accounting Standards Board (GASB) has issued new accounting standards, Statements No. 43 and 45, relating to Other Postemployment Benefits (OPEB). Under these statements, public employers sponsoring and subsidizing retiree healthcare benefit programs will need to recognize the cost of such benefits on an accrual basis.

The State of California provides medical, prescription drug, and dental benefits (healthcare benefits) to retired statewide employees. The State also offers life insurance, long-term care, and vision benefits to retirees; however, because these benefits are completely paid for by retirees, there is no GASB No. 45 liability to the State.

The State is required to adopt the provisions of GASB No. 45 for the fiscal year beginning July 1, 2007. This report was prepared in accordance with the requirements of GASB Nos. 43 and 45 and provides:

1. An actuarial valuation as of July 1, 2007, of the retiree healthcare benefits sponsored by the State of California for statewide employees,
2. FY 2008 expense and financial reporting information, and
3. Alternative valuation results showing the financial impact of pre-funding retiree healthcare benefits.

We are not aware of any other OPEB offered to statewide employees that are subsidized by the State of California, and subject to GASB Nos. 43 and 45.

Background and Key Definitions

Prior to the adoption of GASB No. 45, public sector employers recognized accounting expense for retiree healthcare benefits on a cash basis, meaning that expense was equal to retiree healthcare claims expenditures incurred during the year. Because employers paid most of the claims expenditures during the course of the fiscal year, the accounting or balance sheet liability was relatively low.

GASB No. 45 requires that employers accrue the value of retiree healthcare earned during the employee's working lifetime. Changing the expense recognition from a cash to an accrual basis, requires performing an actuarial valuation and developing the following:

1. *Present value of future healthcare benefits* expected to be paid to current and future retirees.
2. *Actuarial Accrued Liability* is the present value of future retiree healthcare benefits attributable to employee service earned in prior fiscal years.
3. *Normal Cost* is the present value of future benefits earned by employees during the current fiscal year.
4. *Annual Required Contribution or ARC* equals the Normal Cost plus an amortization of the difference between the Actuarial Accrued Liability and any assets available to pay benefits.
5. *Annual OPEB Cost* equals the ARC plus a technical adjustment based on the balance sheet liability at the beginning of the fiscal year. In the first fiscal year that GASB No. 45 is adopted, the Annual OPEB Cost will usually equal the ARC because the initial balance sheet liability is zero.
6. *Net OPEB Obligation* or balance sheet liability equals the cumulative difference between the Annual OPEB Cost and actual employer contributions.

Please note that the Actuarial Accrued Liability impacts the development of the ARC, and is disclosed in the employer's notes to the financial statement, but is not a component of the employer's balance sheet or accounting liability.

The ARC is accrued on the employer's book and is not necessarily the same as the employer's actual cash contribution. An employer may decide to contribute the minimum amount needed to sustain the program, commonly referred to as pay-as-you-go funding. In this case, the balance sheet liability will grow significantly. Other employers may decide to fully-fund the value of the retiree healthcare benefits and contribute the entire ARC into a separate retiree healthcare trust. For such employers, the balance sheet liability will be zero.

The valuation depends primarily on the interest discount rate assumption used to develop the present value of future benefits. The interest discount rate is based on the assets available to pay benefits. Plan sponsors that finance benefits on a pay-as-you-go basis typically pay retiree healthcare benefits from the general fund. Because an employer's general fund is primarily invested in short-term securities, a low investment return assumption, such as 4 percent to 5 percent, is typically used to develop the present value of future benefits. However, plan sponsors that fully-fund retiree healthcare benefits in a separate trust may be able to construct a diversified investment portfolio that generates much higher returns such as 7 percent to 8 percent. Using a higher discount rate such as 8 percent will produce a lower ARC when compared to a discount rate of 4 percent. Also, as assets in the trust accumulate, investment income will also grow thus lowering the overall costs to the employer.

Other key assumptions such as – healthcare inflation, projected healthcare claims, the likelihood an employee retires, elects healthcare coverage, and survives after retirement – will also impact costs.

California State Employees—GASB No. 45 Valuation Results

The following section presents the key GASB No. 45 valuation and accounting results for retiree healthcare benefits offered to California State employees. The Actuarial Accrued Liabilities are measured as of July 1, 2007, based on census data as of March 1, 2007.

The Annual Required Contribution (ARC) is defined as the Normal Cost plus a 30-year level-percent-of-pay amortization of the Unfunded Actuarial Accrued Liability. The Annual OPEB Cost equals the ARC because the initial balance sheet liability is zero.

The valuation was performed assuming three alternative funding options and discount rates:

- Under the pay-as-you-go funding scenario, the State is assumed to finance retiree healthcare benefits from assets available in the general fund. Based on the State's Pooled Money Investment Account (PMIA) investment policy and historical returns, an investment return of 4.5 percent can be supported.
- Under the full-funding scenario, the State is assumed to fully fund the ARC in a separate trust, earmarked solely for retiree healthcare benefits, with an investment policy that can support a discount rate of 7.75 percent.
- Under the partial funding scenario, the State is assumed to contribute 50 percent of the excess of the full funding ARC over the pay-as-you-go costs, resulting in a discount rate of 6.125 percent.

Pay-as-you-go funding at 4.5 percent—\$47.88 billion Actuarial Accrued Liability

The pay-as-you-go funding scenario produced an actuarial accrued liability of \$47.88 billion as of July 1, 2007, an ARC of \$3.59 billion for fiscal year end June 30, 2008, estimated employer contributions of \$1.36 billion for fiscal year end June 30, 2008, and an expected Net OPEB Obligation of \$2.23 billion at fiscal year end June 30, 2008.

Partial-funding at 6.125 percent—\$38.24 billion Actuarial Accrued Liability

The partial-funding scenario produced an actuarial accrued liability of \$38.24 billion as of July 1, 2007, an ARC of \$2.98 billion for fiscal year end June 30, 2008, estimated employer contributions of \$1.98 billion for fiscal year end June 30, 2008, and an expected Net OPEB Obligation of \$1.00 billion at fiscal year end June 30, 2008.

Full-funding at 7.75 percent—\$31.28 billion Actuarial Accrued Liability

The full-funding scenario produced an actuarial accrued liability of \$31.28 billion as of July 1, 2007, an ARC of \$2.59 billion for fiscal year end June 30, 2008, estimated employer contributions of \$2.59 billion for fiscal year end June 30, 2008, and an expected Net OPEB Obligation of \$0.00 billion at fiscal year end June 30, 2008.

Comparison of key valuation results

Fiscal Year Ending June 30, 2008 (\$ in billions)	Pay-As-You-Go Funding (4.5%)	Partial Funding Policy (6.125%)	Full Funding Policy (7.75%)
Actuarial Accrued Liability as of July 1, 2007	\$47.88	\$38.24	\$31.28
Annual Required Contributor for FY 2008	\$3.59	\$2.98	\$2.59
Expected Employer Contribution for FY 2008	\$1.36	\$1.98	\$2.59
Net OPEB obligation for FYE 2008	\$2.23	\$1.00	\$0.00

Fully funding retiree healthcare benefits increases cash contributions by 90 percent from \$1.36 billion to \$2.59 billion; however, the result is no balance sheet liability at fiscal year end 2008. The partial funding policy also controls the growth in the balance sheet liability and reduces the balance sheet liability at fiscal year end 2008 by approximately 55 percent from \$2.23 billion to \$1.00 billion.

Basis of actuarial valuation

This preceding valuation results were based on:

- The provisions of GASB Statements No. 43 and 45,
- The provisions of Actuarial Standard of Practice No. 6, *Measuring Retiree Group Benefit Obligations*,
- Census information as of March 1, 2007, provided by the California Public Employees Retirement System (CalPERS) and the Department of Personnel Administration (DPA),
- Claims and enrollment data provided by CalPERS and DPA for calendar years 2004, 2005, and 2006,
- Plan information provided by CalPERS and DPA,
- Demographic assumptions consistent with those used for the most recent actuarial valuations of the CalPERS statewide pension programs,
- Retiree healthcare valuation assumptions and methods consistent with the CalPERS OPEB parameters, and
- Economic and other demographic assumptions such as the discount rate, healthcare inflation, healthcare claim costs, and healthcare plan participation as recommended by Gabriel, Roeder, Smith & Co. and approved by the SCO.

The valuation was prepared by a member of the American Academy of Actuaries who satisfies the Qualification Standards of the Academy to render an actuarial opinion on the valuation of retiree healthcare benefits.

The remainder of the report is an integral component of the valuation and includes:

- An overview of the GASB Statements No. 43 and 45 requirements;
- Background on retiree healthcare trusts including the advantages of pre-funding;
- The basis of the actuarial assumptions and methods used in this valuation;
- Valuation results by employer group;
- Fiscal year end 2008 financial disclosure information; and
- Additional details on the census, plan provisions, assumptions, and methods used to prepare the valuation.

Appendix 7

Appendix 7

Alternate GRS Scenarios

December 7, 2007

Ms. Anne Sheehan
Executive Director
California Public Employee Postemployment Benefits Commission
980 9th Street, Suite 1760
Sacramento, California 95814

Re: State of California Retiree Healthcare Benefits – GASB 45 Closed Group Projections

Dear Ms. Sheehan:

We have completed the GASB 45 projection scenarios requested by the California Public Employee Postemployment Benefits Commission (PEBC). The primary purpose of the projections is to evaluate the sensitivity of the healthcare inflation assumption.

The projections were based on the GASB 45 actuarial valuation as of July 1, 2007, with adjustments for healthcare trend experience and plan design changes effective January 1, 2008. The closed group projections reflect postemployment liabilities for current employees and retirees only, and do not include liabilities for future hires. Alternative projections were performed assuming a pay-as-you-go policy, based on a 4.5 percent discount rate, and a full-funding financing policy, based on a 7.75 percent discount rate. The healthcare trend scenarios used in the projections are outlined below:

1. Current trend rates
2. 100 basis point increase in current trend rates
3. 10 percent trend rate for first ten years and six percent trend rate thereafter

The key findings and observations are summarized below.

Updated Healthcare Trend and Plan Design

Based on information provided by CalPERS for calendar year 2008, projected healthcare trend increased cash costs by approximately 10.2 percent, and plan design changes decreased cash costs by approximately 5.9 percent for the PPO and 2.8 percent for the HMOs.

The updated trend and plan design features, effective on January 1, 2008, decreased GASB 45 accrued costs at July 1, 2007, as follows:

(\$ In billions)	Actuarial Accrued Liability At July 1, 2007	Annual Required Contribution for FY 07/08
Pay-As-You-Go Funding (4.5%)		
• Baseline	\$47.88	\$3.59
• After Trend and Design Changes	\$46.21	\$3.47
• Decrease	\$1.67	\$0.12
• Percentage Decrease	3.5%	3.3%
Full Funding (7.75%)		
• Baseline	\$31.28	\$2.59
• After Trend and Design Changes	\$30.20	\$2.50
• Decrease	\$1.08	\$0.09
• Percentage Decrease	3.5%	3.5%

The preceding table indicates that the plan changes which become effective on January 1, 2008, are projected to decrease GASB 45 costs by approximately 3.5 percent for FY 07/08. Please note that these cost savings are for illustration purposes only. FY 07/08 GASB 45 costs for financial reporting purposes will be based on our valuation issued on May 7, 2007, to the State's Controller's Office, as shown in the baseline results above.

Closed Group Projections Based on Current Trend Assumption

Closed group projections based on the current trend assumption with updates for plan design are shown in graphical and tabular form in Graph I and Table I. The key observations include:

- Graph I(a) compares the actuarial liabilities under both the pay-as-you-go and full-funding policies. Under each funding policy, actuarial liabilities are projected to grow over the next 20 years and then decline. This pattern is consistent with a close group projection. That is, members are projected to retire, and collect benefits for 15 to 20 years on average. After 30 years actuarial liabilities are projected to grow to \$62 billion under the pay-as-you-go scenario and \$48 billion under the full-funding scenario.
- Graph I(b) shows the projected growth in funded ratio over the 30-year projection period. Under the full-funding policy, the funded ratio approaches 100 percent after 30 years.
- Graph I(c) compares the projected GASB 45 annual required contribution (ARC) and employer contributions under both the pay-as-you-go and full funding policies. After about 12 years the full-funding employer contribution or ARC is projected to be less than the pay-as-you-go employer contribution. This demonstrates the advantages of pre-funding a retiree healthcare program. As assets grow, investment income is used to finance a portion of the retiree healthcare liability.

- Graph I(d) shows the projected growth in the balance sheet liability. After the 30-year projection period, the balance sheet liability remains at zero under the full-funding policy but will grow to over \$56 billion or 90 percent of the actuarial liability of \$62 billion under the pay-as-you-go policy.
- Graph I(e) compares the components of the expected retiree healthcare benefits over a 60-year period. The graph shows an increase in the employer explicit subsidy due to the effects of trend and growth in the number of retirees. After approximately 30 years, the total explicit subsidy decreases as the number of retired members decreases.

Closed Group Projections Based on Trend Assumption Sensitivity

The results of the closed group projections based on trend sensitivity assumptions are shown in graphical and tabular form in Graph II and Table II. Table III contains the trend assumptions used in each scenario as well as the population projection. The key results are summarized below:

Actuarial Liabilities (\$ In billions)	Graph II(a) – PAYGO		Graph II(b) – Full Funding	
	7/1/2007	7/1/2038	7/1/2007	7/1/2038
Baseline trend	\$46.2	\$62.3	\$30.2	\$47.8
100 basis point increase (percent increase over baseline)	\$54.7 (18%)	\$91.3 (47%)	\$34.5 (14%)	\$68.8 (44%)
Flat trend at 10% for 10 years (percent increase over baseline)	\$63.5 (37%)	\$119.9 (92%)	\$39.0 (29%)	\$89.6 (87%)

Annual Required Contribution (\$ In billions)	Graph II(c) – PAYGO		Graph II(d) – Full Funding	
	7/1/2007	7/1/2038	7/1/2007	7/1/2038
Baseline trend	\$3.47	\$4.64	\$2.50	\$0.25
100 basis point increase (percent increase over baseline)	\$4.28 (23%)	\$6.81 (47%)	\$2.93 (17%)	\$0.33 (32%)
Flat trend at 10% for 10 years (percent increase over baseline)	\$5.11 (47%)	\$8.94 (93%)	\$3.38 (35%)	\$0.41 (64%)

The key observations include:

- Graph II(a) shows how changes in trend are projected to impact actuarial liabilities under the pay-as-you-go funding policy. For FY 07/08 increasing the select and ultimate trend rates by 100 basis points, increases the actuarial liability at July 1, 2007, by 18 percent from \$46.2 billion to \$54.7 billion. However, after the 30-year projection period, a 100 basis point increase in trend is projected to increase actuarial liabilities by 47 percent from \$62.3 billion to \$91.3 billion. This is due to the compounding effect of trend over the 30-year projection period.
- Graph II(a) also shows the impact, on the pay-as-you-go policy, of allowing trend to remain flat at 10 percent for ten years and drop to six percent after the tenth year. This scenario has a greater impact than increasing trend by 100 basis points. For FY 07/08, the actuarial liability is approximately 37 percent higher than the baseline costs. After 30 years, this scenario produces costs that are 92 percent higher than baseline costs.
- Graph II(b) shows how the actuarial liabilities are impacted by changing trend under the full-funding policy. When trend sensitivity is evaluated as a percentage increase in actuarial liability, increasing the discount rate slightly dampens the impact of trend. For example, under the full-funding policy, increasing trend by 100 basis points increases the actuarial liability by 14 percent in the first projection year and by 44 percent in the 30th projection year, compared to percentage increases in actuarial liability under the pay-as-you-go funding policy of 18 percent and 47 percent, respectively.
- Graph II(c) shows how trend sensitivity can impact the GASB 45 annual required contribution (ARC) under the pay-as-you-go policy. The compounding effect of trend impacts the ARC and the normal cost more than the actuarial liability. This explains why the percentage increase in FY 08 is higher for the ARC when compared to the actuarial liability. After 30 years, the normal cost approaches zero and the increase in ARC and actuarial liabilities are similar.
- Graph II(d) shows how trend sensitivity can impacts the ARC under the full funding policy. For FY 07/08 the increase in the ARC is consistent with the pay-as-you-go policy; however, under the 30-year projection the ARC approaches zero and the percentage increase has less meaning.
- Graph II(e) shows the impact of trend on expected benefit payments and illustrates the compounding effect of trend.

Summary and Conclusions

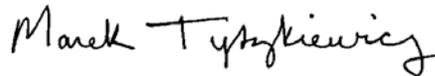
The preceding projections illustrate the sensitivity of healthcare trend on GASB 45 costs. The current baseline trend assumption set is consistent with generally accepted actuarial standards of practice and is considered to be “mainstream.” The baseline trend assumes that healthcare inflation will eventually level to a rate of about 100 to 150 basis above general price inflation. Over the past ten years this assumption has not been

realized. That is, historical trend over the past 10 years has been closer to 10 percent. Consequently, examining the sensitivity of trend may help plan for the future. However, performing projections on a closed group basis may not fully measure the potential impact of healthcare trend sensitivity, and we recommend that the PEBC evaluate how trend sensitivity impacts projections on both a closed group and open group basis.

Sincerely,



Alex Rivera, F.S.A.
Senior Consultant



Marek Tyszkiewicz, A.S.A.
Senior Consultant

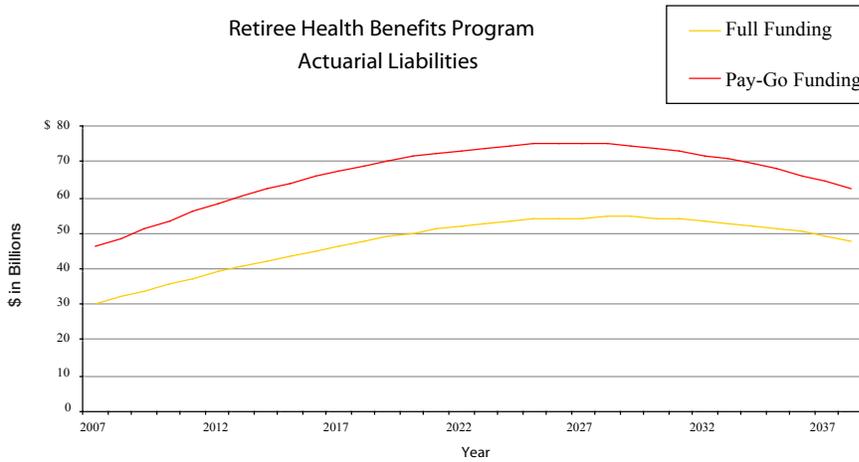
cc: Mr. Michael Carter, California State Controllers Office
Mr. John Korach, California State Controllers Office

Enclosure

State of California – Closed Group GASB 43/45 Projections Baseline Trend with 2008 Plan Design Updates¹

Appendix 7

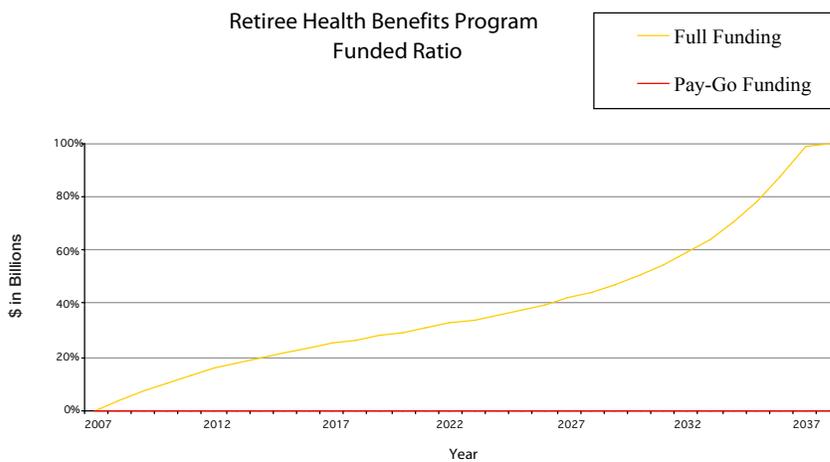
Graph I(a)



¹ 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. The medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007.

State of California – Closed Group GASB 43/45 Projections Baseline Trend with 2008 Plan Design Updates²

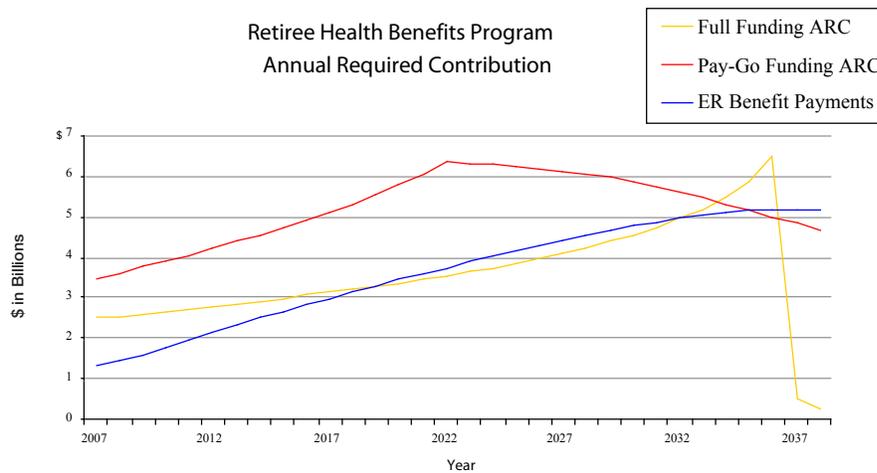
Graph I(b)



² 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. The medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007.

State of California – Closed Group GASB 43/45 Projections
Baseline Trend with 2008 Plan Design Updates¹

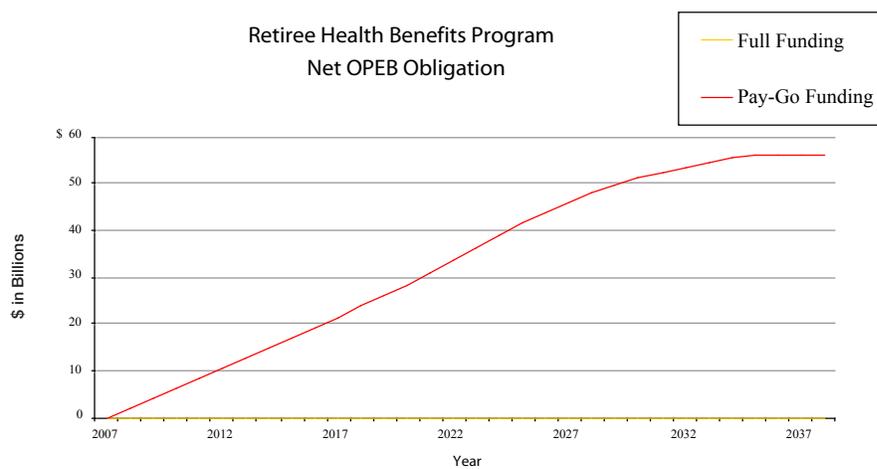
Graph I(c)



¹ 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. The medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007. Under the pay-as-you-go policy, unfunded actuarial liability is amortized over the greater of a 30-year closed period or the life expectancy of retirees. The life expectancy is assumed to be at least 15 years over the 30 year projection period.

State of California – Closed Group GASB 43/45 Projections
Baseline Trend with 2008 Plan Design Updates²

Graph I(d)

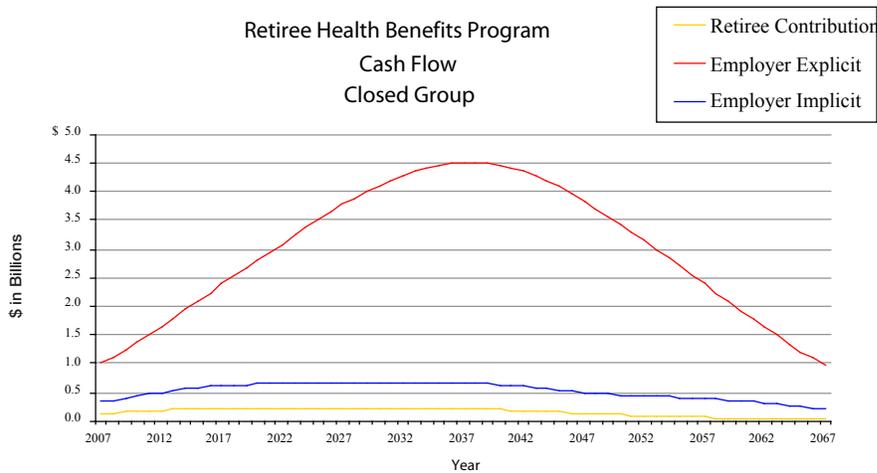


² 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. The medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007.

State of California – Closed Group GASB 43/45 Projections Baseline Trend with 2008 Plan Design Updates¹

Appendix 7

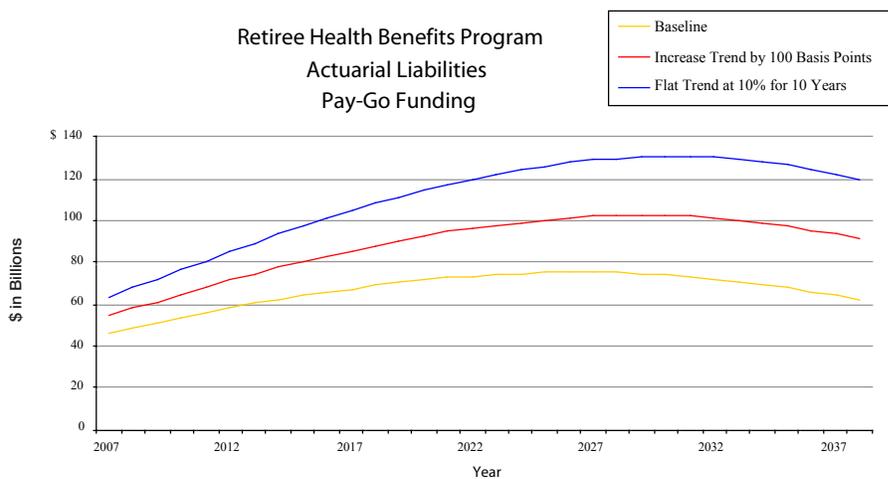
Graph I(e)



¹ 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. The medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007.

State of California – Closed Group GASB 43/45 Projections Baseline Trend with 2008 Plan Design Updates²

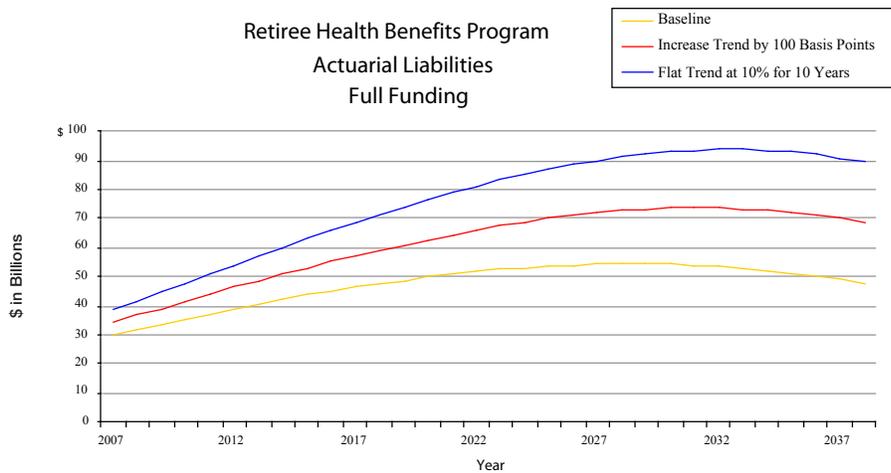
Graph II(a)



² 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. Under the Baseline scenario, the medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007. Under the Increase Trend by 100 Basis Points scenario, the medical and dental trend assumptions are increased by 100 basis points over the baseline assumption. Under the Flat Trend for Ten Years scenario, the medical trend assumption after 2008 remains at ten percent until 2017. After 2017, the trend assumption will remain at six percent. Dental Trend after 2008 is assumed to be level at six percent.

State of California – Closed Group GASB 43/45 Projections
Baseline Trend with 2008 Plan Design Updates¹

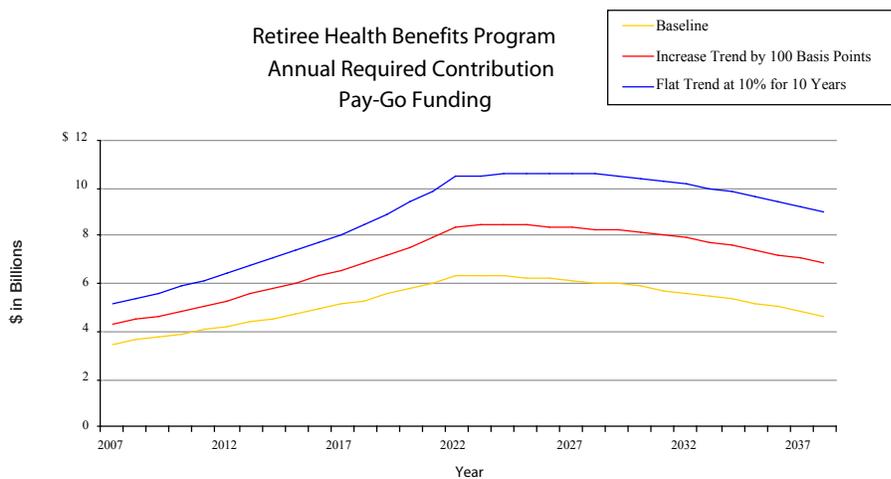
Graph II(b)



¹ 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. Under the Baseline scenario, the medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007. Under the Increase Trend by 100 Basis Points scenario, the medical and dental trend assumptions are increased by 100 basis points over the baseline assumption. Under the Flat Trend for Ten Years scenario, the medical trend assumption after 2008 remains at ten percent until 2017. After 2017, the trend assumption will remain at six percent. Dental Trend after 2008 is assumed to be level at six percent.

State of California – Closed Group GASB 43/45 Projections
Baseline Trend with 2008 Plan Design Updates²

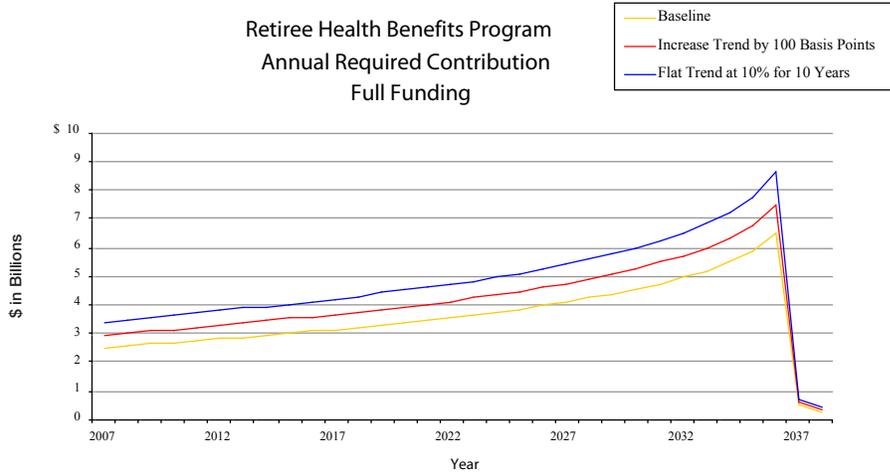
Graph II(c)



² 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. Under the Baseline scenario, the medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007. Under the Increase Trend by 100 Basis Points scenario, the medical and dental trend assumptions are increased by 100 basis points over the baseline assumption. Under the Flat Trend for Ten Years scenario, the medical trend assumption after 2008 remains at ten percent until 2017. After 2017, the trend assumption will remain at six percent. Dental Trend after 2008 is assumed to be level at six percent.

State of California – Closed Group GASB 43/45 Projections Baseline Trend with 2008 Plan Design Updates¹

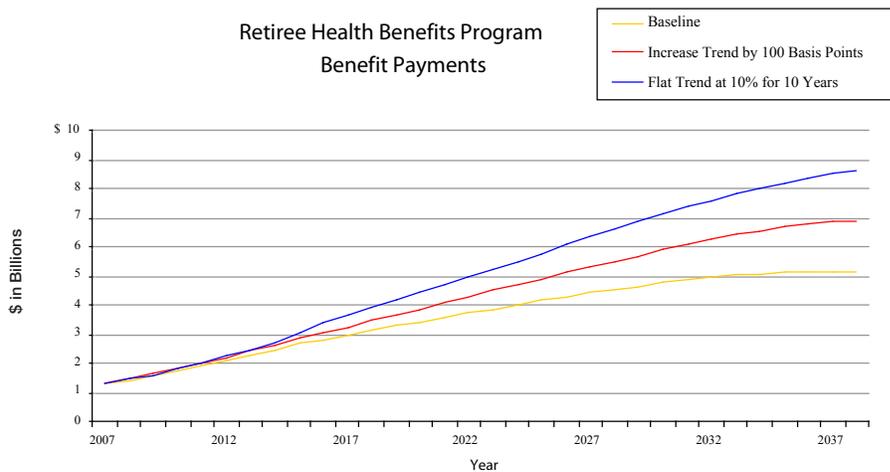
Graph II(d)



¹ 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. Under the Baseline scenario, the medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007. Under the Increase Trend by 100 Basis Points scenario, the medical and dental trend assumptions are increased by 100 basis points over the baseline assumption. Under the Flat Trend for Ten Years scenario, the medical trend assumption after 2008 remains at ten percent until 2017. After 2017, the trend assumption will remain at six percent. Dental Trend after 2008 is assumed to be level at six percent.

State of California – Closed Group GASB 43/45 Projections Baseline Trend with 2008 Plan Design Updates²

Graph II(e)



² 2008 trend is based on actual plan experience. The medical trend assumption, including 2008 plan design adjustments, decreased from 10.0 percent in 2008 for HMO and PPO plans to 7.4 percent for HMO plans and 4.2 percent for PPO plans. The dental trend assumption decreased from 6.0 percent to 0.3 percent. Under the Baseline scenario, the medical and dental trend assumptions after 2008 remain unchanged from the valuation report as of July 1 2007. Under the Increase Trend by 100 Basis Points scenario, the medical and dental trend assumptions are increased by 100 basis points over the baseline assumption. Under the Flat Trend for Ten Years scenario, the medical trend assumption after 2008 remains at ten percent until 2017. After 2017, the trend assumption will remain at six percent. Dental Trend after 2008 is assumed to be level at six percent.

State of California Employees - GASB 45 Projections
 Closed Group Projections, Baseline
 Results Based on 7/1/2007 Valuation, with updated 2008 Trend
 (\$ in thousands)

Table I(a)

Public Employee
 Post-Employment
 Benefits Commission

Appendix 7

Actuarial Liabilities

Year	Pay-As-You-Go	Full Funding
2007	46,213,349	30,195,730
2008	48,684,253	31,988,515
2009	51,152,601	33,812,129
2010	53,558,605	35,608,916
2011	55,884,595	37,363,556
2012	58,116,001	39,063,906
2013	60,245,142	40,704,869
2014	62,256,895	42,274,194
2015	64,138,605	43,761,745
2016	65,881,616	45,161,041
2017	67,490,428	46,478,711
2018	68,970,541	47,722,572
2019	70,313,494	48,886,086
2020	71,510,239	49,961,707
2021	72,551,196	50,940,695
2022	73,429,309	51,816,541
2023	74,138,179	52,583,367
2024	74,668,647	53,232,095
2025	75,013,053	53,754,571
2026	75,168,706	54,147,263
2027	75,133,824	54,407,200
2028	74,905,508	54,529,759
2029	74,483,069	54,511,976
2030	73,865,350	54,350,087
2031	73,051,234	54,039,820
2032	72,041,947	53,578,735
2033	70,842,201	52,967,483
2034	69,458,412	52,207,895
2035	67,901,782	51,306,074
2036	66,188,759	50,273,204
2037	64,333,326	49,066,808
2038	62,273,372	47,752,696

State of California Employees - GASB 45 Projections
Closed Group Projections, Baseline
Results Based on 7/1/2007 Valuation, with updated 2008 Trend
(\$ in thousands)

Table I(b)

Year	Funded Ratio	
	Pay-As-You-Go	Full Funding
2007	0.0%	0.0%
2008	0.0%	3.7%
2009	0.0%	7.2%
2010	0.0%	10.3%
2011	0.0%	13.0%
2012	0.0%	15.5%
2013	0.0%	17.7%
2014	0.0%	19.7%
2015	0.0%	21.6%
2016	0.0%	23.3%
2017	0.0%	24.8%
2018	0.0%	26.4%
2019	0.0%	27.9%
2020	0.0%	29.4%
2021	0.0%	30.9%
2022	0.0%	32.5%
2023	0.0%	34.1%
2024	0.0%	35.8%
2025	0.0%	37.6%
2026	0.0%	39.7%
2027	0.0%	41.9%
2028	0.0%	44.4%
2029	0.0%	47.3%
2030	0.0%	50.6%
2031	0.0%	54.4%
2032	0.0%	58.9%
2033	0.0%	64.2%
2034	0.0%	70.5%
2035	0.0%	78.0%
2036	0.0%	87.3%
2037	0.0%	99.1%
2038	0.0%	99.6%

State of California Employees - GASB 45 Projections
 Closed Group Projections, Baseline
 Results Based on 7/1/2007 Valuation, with updated 2008 Trend
 (\$ in thousands)

Table I(c)

Public Employee
 Post-Employment
 Benefits Commission

Appendix 7

Annual Required Contribution

Year	Pay-As-You-Go	Full Funding	Benefit Payments
2007	3,473,030	2,500,812	1,357,052
2008	3,610,217	2,558,185	1,455,997
2009	3,756,173	2,617,926	1,614,065
2010	3,906,892	2,678,899	1,783,646
2011	4,061,794	2,740,868	1,960,142
2012	4,220,606	2,803,661	2,135,627
2013	4,383,564	2,867,199	2,316,156
2014	4,551,271	2,931,688	2,498,724
2015	4,725,109	2,997,609	2,679,213
2016	4,906,603	3,065,310	2,844,262
2017	5,098,376	3,135,168	2,993,312
2018	5,304,014	3,207,823	3,141,690
2019	5,526,815	3,283,985	3,290,383
2020	5,770,493	3,364,302	3,440,188
2021	6,039,164	3,449,285	3,588,430
2022	6,337,745	3,539,310	3,734,079
2023	6,323,109	3,635,063	3,879,800
2024	6,294,884	3,737,475	4,024,415
2025	6,252,814	3,847,328	4,163,037
2026	6,197,197	3,965,602	4,295,002
2027	6,128,445	4,093,483	4,421,830
2028	6,046,941	4,232,440	4,541,782
2029	5,952,994	4,384,189	4,655,495
2030	5,846,917	4,551,037	4,763,309
2031	5,729,110	4,736,282	4,863,295
2032	5,599,968	4,944,822	4,952,387
2033	5,460,478	5,185,071	5,029,718
2034	5,311,662	5,473,214	5,091,461
2035	5,154,728	5,848,678	5,133,324
2036	4,991,091	6,467,015	5,158,534
2037	4,821,629	486,833	5,168,456
2038	4,641,791	249,942	5,159,652

State of California Employees - GASB 45 Projections
Closed Group Projections, Baseline
Results Based on 7/1/2007 Valuation, with updated 2008 Trend
(\$ in thousands)

Net OPEB Obligation		
Year	Pay-As-You-Go	Full Funding
2007	-	-
2008	2,115,978	-
2009	4,281,892	-
2010	6,447,664	-
2011	8,606,543	-
2012	10,755,758	-
2013	12,900,179	-
2014	15,038,880	-
2015	17,174,539	-
2016	19,315,350	-
2017	21,484,437	-
2018	23,708,235	-
2019	26,001,583	-
2020	28,381,712	-
2021	30,868,868	-
2022	33,490,198	-
2023	36,278,947	-
2024	38,922,750	-
2025	41,408,325	-
2026	43,726,945	-
2027	45,870,796	-
2028	47,830,915	-
2029	49,600,411	-
2030	51,172,026	-
2031	52,538,435	-
2032	53,694,602	-
2033	54,638,926	-
2034	55,371,646	-
2035	55,897,857	-
2036	56,228,180	-
2037	56,371,481	-
2038	56,336,190	-

State of California Employees - GASB 45 Projections
 Closed Group Projections, Baseline
 Results Based on 7/1/2007 Valuation, with updated 2008 Trend
 (\$ in thousands)

Table I(e)

Public Employee
 Post-Employment
 Benefits Commission

Appendix 7

Employer/Retiree Share

Year	Retiree Contribution	Employer Explicit	Employer Implicit
2007	138,636	1,022,256	334,796
2008	142,845	1,100,363	355,634
2009	152,196	1,221,153	392,911
2010	161,975	1,351,469	432,177
2011	171,816	1,489,651	470,491
2012	181,036	1,633,502	502,125
2013	190,263	1,783,625	532,530
2014	199,126	1,938,294	560,430
2015	207,107	2,094,014	585,198
2016	213,341	2,240,780	603,482
2017	218,074	2,377,585	615,727
2018	222,133	2,516,183	625,507
2019	225,591	2,657,114	633,270
2020	228,332	2,799,724	640,464
2021	230,366	2,942,724	645,706
2022	231,828	3,085,568	648,512
2023	233,005	3,228,137	651,663
2024	233,853	3,369,224	655,191
2025	233,943	3,506,868	656,169
2026	233,739	3,639,880	655,122
2027	233,428	3,767,619	654,211
2028	232,735	3,888,635	653,146
2029	231,797	4,002,392	653,102
2030	230,729	4,108,296	655,014
2031	229,386	4,204,983	658,312
2032	227,591	4,291,020	661,366
2033	225,473	4,365,196	664,522
2034	222,869	4,425,536	665,925
2035	219,524	4,470,183	663,142
2036	215,446	4,499,580	658,955
2037	210,658	4,514,037	654,419
2038	204,913	4,512,538	647,114

State of California Employees - GASB 45 Projections
Closed Group Projections, Baseline
Results Based on 7/1/2007 Valuation, with updated 2008 Trend
(\$ in thousands)

Year	Employer/Retiree Share		
	Retiree Contribution	Employer Explicit	Employer Implicit
2039	198,502	4,495,418	638,361
2040	191,527	4,462,762	628,217
2041	183,937	4,414,250	614,222
2042	175,862	4,350,627	596,010
2043	167,463	4,273,382	576,557
2044	158,775	4,183,051	555,713
2045	149,867	4,080,388	532,952
2046	140,961	3,967,209	510,754
2047	132,169	3,845,366	491,407
2048	123,493	3,716,146	474,526
2049	115,030	3,581,068	460,710
2050	106,916	3,441,584	450,828
2051	99,191	3,298,013	443,015
2052	91,868	3,150,870	435,976
2053	84,941	3,000,906	429,229
2054	78,373	2,848,647	421,761
2055	72,087	2,694,615	412,681
2056	66,148	2,539,565	401,905
2057	60,513	2,384,142	389,443
2058	55,177	2,229,064	375,432
2059	50,141	2,075,110	359,883
2060	45,405	1,923,057	342,986
2061	40,954	1,773,624	324,978
2062	36,779	1,627,472	306,048
2063	32,904	1,485,249	286,333
2064	29,300	1,347,608	266,190
2065	25,957	1,215,125	245,711
2066	22,866	1,088,371	225,084
2067	20,020	967,914	204,592

State of California Employees - GASB 45 Projections
 Closed Group Projections, Pay-As-You-Go Funding
 Results Based on 7/1/2007 Valuation, with updated 2008 Trend
 (\$ in thousands)

Table II(a)

Year	Actuarial Liabilities		
	Baseline	Increase Trend by 100 Basis Points	Flat Trend at 10% for 10 Years
2007	46,213,349	54,708,161	63,497,554
2008	48,684,253	58,054,232	67,747,482
2009	51,152,601	61,426,507	72,075,663
2010	53,558,605	64,762,344	76,418,565
2011	55,884,595	68,041,300	80,751,047
2012	58,116,001	71,245,152	85,047,196
2013	60,245,142	74,362,278	89,284,159
2014	62,256,895	77,372,919	93,426,971
2015	64,138,605	80,259,337	97,438,211
2016	65,881,616	83,007,768	101,277,365
2017	67,490,428	85,618,472	104,901,654
2018	68,970,541	88,092,909	108,289,918
2019	70,313,494	90,417,497	111,502,511
2020	71,510,239	92,577,819	114,530,811
2021	72,551,196	94,558,648	117,354,499
2022	73,429,309	96,347,463	119,956,251
2023	74,138,179	97,932,106	122,318,920
2024	74,668,647	99,297,087	124,421,316
2025	75,013,053	100,428,408	126,243,760
2026	75,168,706	101,317,694	127,773,033
2027	75,133,824	101,957,679	128,997,193
2028	74,905,508	102,339,740	129,902,569
2029	74,483,069	102,457,963	130,478,691
2030	73,865,350	102,305,880	130,714,401
2031	73,051,234	101,877,079	130,598,518
2032	72,041,947	101,168,192	130,123,559
2033	70,842,201	100,180,341	129,287,565
2034	69,458,412	98,917,130	128,091,692
2035	67,901,782	97,388,698	126,545,387
2036	66,188,759	95,612,531	124,667,405
2037	64,333,326	93,603,453	122,473,558
2038	62,273,372	91,285,154	119,877,018

State of California Employees - GASB 45 Projections
Closed Group Projections, Full Funding
Results Based on 7/1/2007 Valuation, with updated 2008 Trend
(\$ in thousands)

Year	Actuarial Liabilities		
	Baseline	Increase Trend by 100 Basis Points	Flat Trend at 10% for 10 Years
2007	30,195,730	34,532,789	39,005,088
2008	31,988,515	36,856,383	41,880,084
2009	33,812,129	39,240,631	44,869,567
2010	35,608,916	41,625,909	47,914,896
2011	37,363,556	43,995,377	50,996,598
2012	39,063,906	46,334,613	54,094,973
2013	40,704,869	48,636,310	57,193,905
2014	42,274,194	50,885,304	60,265,408
2015	43,761,745	53,068,307	63,278,601
2016	45,161,041	55,175,588	66,198,519
2017	46,478,711	57,211,303	68,986,735
2018	47,722,572	59,181,095	71,625,391
2019	48,886,086	61,075,049	74,178,876
2020	49,961,707	62,881,957	76,643,291
2021	50,940,695	64,589,000	79,002,234
2022	51,816,541	66,185,704	81,241,727
2023	52,583,367	67,661,892	83,348,032
2024	53,232,095	69,003,558	85,302,694
2025	53,754,571	70,197,467	87,087,929
2026	54,147,263	71,235,530	88,691,835
2027	54,407,200	72,110,220	90,103,057
2028	54,529,759	72,811,896	91,307,588
2029	54,511,976	73,332,827	92,293,583
2030	54,350,087	73,664,203	93,047,704
2031	54,039,820	73,796,431	93,555,615
2032	53,578,735	73,722,107	93,805,464
2033	52,967,483	73,437,713	93,790,055
2034	52,207,895	72,941,241	93,504,029
2035	51,306,074	72,236,385	92,949,076
2036	50,273,204	71,333,681	92,135,459
2037	49,066,808	70,170,724	90,982,856
2038	47,752,696	68,828,473	89,584,059

State of California Employees - GASB 45 Projections
 Closed Group Projections, Pay-As-You-Go Funding
 Results Based on 7/1/2007 Valuation, with updated 2008 Trend
 (\$ in thousands)

Table II(c)

Public Employee
 Post-Employment
 Benefits Commission

Appendix 7

Year	Annual Required Contribution		
	Baseline	Increase Trend by 100 Basis Points	Flat Trend at 10% for 10 Years
2007	3,473,030	4,277,833	5,106,991
2008	3,610,217	4,460,899	5,337,386
2009	3,756,173	4,656,847	5,585,795
2010	3,906,892	4,861,428	5,847,913
2011	4,061,794	5,074,071	6,123,184
2012	4,220,606	5,294,519	6,411,327
2013	4,383,564	5,523,144	6,712,607
2014	4,551,271	5,760,891	7,027,929
2015	4,725,109	6,009,726	7,359,173
2016	4,906,603	6,271,827	7,708,026
2017	5,098,376	6,550,667	8,076,511
2018	5,304,014	6,850,960	8,468,937
2019	5,526,815	7,177,317	8,895,372
2020	5,770,493	7,535,046	9,363,295
2021	6,039,164	7,930,138	9,880,568
2022	6,337,745	8,369,786	10,456,652
2023	6,323,109	8,401,587	10,527,039
2024	6,294,884	8,415,697	10,575,744
2025	6,252,814	8,411,470	10,601,781
2026	6,197,197	8,388,956	10,605,013
2027	6,128,445	8,348,344	10,585,479
2028	6,046,941	8,289,825	10,543,221
2029	5,952,994	8,213,487	10,478,150
2030	5,846,917	8,119,437	10,390,212
2031	5,729,110	8,007,935	10,279,554
2032	5,599,968	7,879,229	10,146,316
2033	5,460,478	7,734,399	9,991,683
2034	5,311,662	7,574,593	9,816,965
2035	5,154,728	7,401,233	9,623,798
2036	4,991,091	7,216,009	9,414,171
2037	4,821,629	7,019,946	9,189,245
2038	4,641,791	6,807,548	8,942,850

State of California Employees - GASB 45 Projections
Closed Group Projections, Full Funding
Results Based on 7/1/2007 Valuation, with updated 2008 Trend
(\$ in thousands)

Table II(d)

Year	Annual Required Contribution		
	Baseline	Increase Trend by 100 Basis Points	Flat Trend at 10% for 10 Years
2007	2,500,812	2,931,711	3,377,832
2008	2,558,185	2,998,583	3,454,530
2009	2,617,926	3,068,254	3,534,420
2010	2,678,899	3,139,384	3,615,941
2011	2,740,868	3,211,608	3,698,588
2012	2,803,661	3,284,633	3,781,939
2013	2,867,199	3,358,273	3,865,706
2014	2,931,688	3,432,721	3,950,082
2015	2,997,609	3,508,505	4,035,674
2016	3,065,310	3,586,008	4,122,954
2017	3,135,168	3,665,652	4,212,495
2018	3,207,823	3,748,164	4,305,183
2019	3,283,985	3,834,361	4,401,781
2020	3,364,302	3,925,002	4,503,136
2021	3,449,285	4,020,695	4,609,964
2022	3,539,310	4,121,868	4,722,766
2023	3,635,063	4,229,344	4,842,499
2024	3,737,475	4,344,226	4,970,458
2025	3,847,328	4,467,471	5,107,778
2026	3,965,602	4,600,292	5,255,916
2027	4,093,483	4,744,157	5,416,629
2028	4,232,440	4,900,900	5,592,115
2029	4,384,189	5,072,652	5,784,934
2030	4,551,037	5,262,286	5,998,524
2031	4,736,282	5,473,901	6,237,796
2032	4,944,822	5,713,568	6,510,008
2033	5,185,071	5,991,713	6,827,625
2034	5,473,214	6,328,327	7,214,493
2035	5,848,678	6,772,015	7,728,535
2036	6,467,015	7,514,352	8,597,902
2037	486,833	604,969	726,645
2038	249,942	328,003	406,111

State of California Employees - GASB 45 Projections
 Closed Group Projections
 Results Based on 7/1/2007 Valuation, with updated 2008 Trend
 (\$ in thousands)

Table II(e)

Public Employee
 Post-Employment
 Benefits Commission

Appendix 7

Year	Employer Benefit Payments		
	Baseline	Increase Trend by 100 Basis Points	Flat Trend at 10% for 10 Years
2007	1,357,052	1,358,070	1,357,060
2008	1,455,997	1,468,448	1,456,760
2009	1,614,065	1,642,327	1,623,157
2010	1,783,646	1,831,170	1,811,152
2011	1,960,142	2,030,932	2,018,933
2012	2,135,627	2,233,259	2,241,073
2013	2,316,156	2,444,569	2,487,188
2014	2,498,724	2,661,887	2,757,997
2015	2,679,213	2,880,922	3,055,543
2016	2,844,262	3,087,280	3,380,753
2017	2,993,312	3,279,999	3,710,437
2018	3,141,690	3,475,412	3,961,923
2019	3,290,383	3,674,619	4,208,592
2020	3,440,188	3,878,565	4,462,948
2021	3,588,430	4,084,285	4,721,642
2022	3,734,079	4,290,609	4,983,362
2023	3,879,800	4,500,601	5,251,744
2024	4,024,415	4,712,911	5,525,266
2025	4,163,037	4,921,782	5,797,179
2026	4,295,002	5,126,284	6,066,354
2027	4,421,830	5,328,050	6,334,706
2028	4,541,782	5,524,847	6,599,509
2029	4,655,495	5,717,266	6,861,460
2030	4,763,309	5,905,546	7,120,783
2031	4,863,295	6,087,106	7,374,288
2032	4,952,387	6,257,829	7,616,853
2033	5,029,718	6,416,261	7,846,535
2034	5,091,461	6,557,053	8,056,537
2035	5,133,324	6,674,097	8,239,005
2036	5,158,534	6,770,951	8,397,998
2037	5,168,456	6,848,769	8,534,599
2038	5,159,652	6,902,408	8,642,029

State of California Employees - GASB 45 Projections
Closed Group Projections
Results Based on 7/1/2007 Valuation, with updated 2008 Trend

Updated Trend Assumptions

Year	Baseline	
	Med and Rx	Dental
2008	7.4% HMO, 4.2% PPO	0.3%
2009	9.5%	5.5%
2010	9.0%	5.0%
2011	8.5%	4.5%
2012	8.0%	4.5%
2013	7.5%	4.5%
2014	7.0%	4.5%
2015	6.5%	4.5%
2016	5.5%	4.5%
2017	4.5%	4.5%
2018 and beyond	4.5%	4.5%

Increase Trend by 100 Basis Points

Year	Increase Trend by 100 Basis Points	
	Med and Rx	Dental
2008	8.2% HMO, 5.1% PPO	0.3%
2009	10.5%	6.0%
2010	10.0%	5.5%
2011	9.5%	5.5%
2012	9.0%	5.5%
2013	8.5%	5.5%
2014	8.0%	5.5%
2015	7.5%	5.5%
2016	6.5%	5.5%
2017	5.5%	5.5%
2018 and beyond	5.5%	5.5%

Flat Trend at 10% for 10 Years

Year	Flat Trend at 10% for 10 Years	
	Med and Rx	Dental
2008	7.4% HMO, 4.2% PPO	0.3%
2009	10.0%	6.0%
2010	10.0%	6.0%
2011	10.0%	6.0%
2012	10.0%	6.0%
2013	10.0%	6.0%
2014	10.0%	6.0%
2015	10.0%	6.0%
2016	10.0%	6.0%
2017	10.0%	6.0%
2018 and beyond	6.0%	6.0%

State of California Employees - GASB 45 Projections
 Closed Group Projections
 Results Based on 7/1/2007 Valuation, with updated 2008 Trend

Table III(b)

Public Employee
 Post-Employment
 Benefits Commission

Appendix 7

Population Projection

Year	Active Population	Retired Population	Total Population
2007	245,178	130,873	376,051
2008	230,517	141,235	371,752
2009	217,567	145,706	363,273
2010	205,357	150,488	355,845
2011	193,636	155,567	349,203
2012	182,259	160,881	343,140
2013	171,064	166,372	337,437
2014	160,024	171,912	331,936
2015	149,166	177,440	326,605
2016	138,546	182,867	321,413
2017	128,180	188,149	316,329
2018	118,125	193,199	311,324
2019	108,449	197,923	306,372
2020	99,215	202,243	301,458
2021	90,454	206,111	296,565
2022	82,147	209,522	291,669
2023	74,247	212,501	286,748
2024	66,827	214,950	281,777
2025	59,870	216,862	276,732
2026	53,369	218,221	271,589
2027	47,314	219,013	266,327
2028	41,711	219,209	260,920
2029	36,558	218,787	255,346
2030	31,818	217,766	249,584
2031	27,489	216,128	243,618
2032	23,549	213,882	237,431
2033	19,983	211,031	231,014
2034	16,800	207,561	224,360
2035	13,979	203,490	217,469
2036	11,518	198,826	210,344
2037	9,383	193,613	202,996
2038	7,545	187,897	195,443

Appendix 8

Fiduciary Responsibilities of Public Pension Trustees

Note: This document was adapted from a memorandum prepared by Ian D. Lanoff, of the Groom Law Group, Washington, DC.

The following memorandum summarizes the statutory fiduciary duties of board members, officers, and employees of typical statewide public employee pension funds. In some states, including California, constitutions also impose fiduciary responsibilities.

Fiduciary Duties

1. The duty to act prudently.

The statutes typically require Board members to discharge their duties with care, skill, prudence, and diligence that a prudent person would use in similar circumstances. Fiduciaries must act with the degree of skill deployed by other trustees for other pension plans. This is called the “prudent expert” rule.

2. The duty to act “solely in the interest” and for the “exclusive purpose” of serving members.

Fiduciaries are required to act solely in the interest of member, retirees, and their beneficiaries, and for the exclusive purpose of providing them with benefits, and defraying reasonable administrative costs. It is permissible to make decisions using social or non-economic considerations so long as the risk and return characteristics of investment alternatives are equivalent, the so called “everything being equal” test.

3. The duty to act in accordance with governing documents.

4. The duty not to engage in certain transactions.

Most state statutes prohibit the Board from engaging in transactions with parties in which they have a personal interest and transactions involving self dealing.

- a. Board members are prohibited from buying, selling, or leasing of fund property; borrowing or loaning fund money; furnishing goods or services to the fund; and transferring or benefiting from plan assets.
- b. Board members may not cause the fund to acquire property from the state agency from which a member is paid.
- c. Fiduciaries are prohibited from using the fund’s assets for their own interests. This is the provision that should concern elected officials who serve on the Board who may be in a position to hire vendors from whom they have received campaign contributions. This is also the provision that should concern any trustee who receives travel, meal, or entertainment benefits from vendors or potential vendors.
- d. Board members may not receive kickbacks.

Liability for Fiduciary Breach

1. Liability for own breach.

A trustee who breaches any responsibilities is ordinarily personally responsible to restore losses to the fund and disgorge any profits obtained through the breach. The Board is ordinarily

permitted to purchase insurance for its fiduciaries as long as the insurance permits recourse against the fiduciary.

2. Liability for breach of co-fiduciaries.

A fiduciary may be held liable for a breach of a co-fiduciary if he or she knowingly participates in or conceals the breach or has knowledge of a breach and does not take reasonable steps to remedy it.

3. Liability for breach of service provider fiduciaries.

Many statutes provide that fiduciaries are not liable for actions of investment managers as long as they satisfy the prudence standard in selecting and monitoring investment managers, but fiduciaries may not be shielded with respect to the performance of other, non-investment manager fiduciaries such as consultants, brokers, or custodians.

Appendix 9

Responses to “30 Ways to Spike Your Pension” Document

At the Commission’s August 23, 2007 hearing in San Jose, Mr. Ted Costa, a spokesman for People’s Advocate, spoke about the problem of pension spiking in California and gave the Commission a document which he called, “Thirty Ways to Spike Your Pension”.

The Commission provided the document to the Los Angeles County Employees’ Retirement Association California Public Employees’ Retirement System (CalPERS), and the California State Teachers’ Retirement System (CalSTRS) with the request that they consider and respond to each of the 30 items. Since these three systems are governed by the three major retirement laws in California, their combined responses provide a good overview of how pension spiking is being addressed in this state.

A brief summary of each system’s approach to addressing spiking is presented in the Recommendations section of this report. This section provides each system’s complete response to the “Thirty Ways” document.

**Los Angeles County Employees' Retirement Association (LACERA)
Response to
"Thirty Ways to Spike Your Pension" Document**

October 23, 2007

Mr. Tom Branan
Policy Director
Public Employee Post-Employment
Benefits Commission
980 9th Street, Suite 1760
Sacramento, CA 95814-2719

Dear Mr. Branan,

At a recent Public Employee Post-Employment Benefits Commission meeting a document titled "Pension Spiking" was provided to the commission from a source identified as People's Advocate, Inc. The list includes numerous forms of compensation that supposedly spike the calculation of defined benefits. I believe the list to be misleading when applied to the Los Angeles County Employees Retirement Association and county retirement systems in general.

The following includes an abbreviated history demonstrating how court rulings affect how County retirement systems recognize compensation, the deliberative measures taken by the Los Angeles County Employees Retirement Association (LACERA) to mitigate the risk of pension spiking, and a detailed review of the People's Advocate, Inc, pension spiking list.

Pensionable Earnings

LACERA relies upon its participating employers to report employee earnings that are ultimately used in calculating retirement benefits. These earnings are commonly cited as "pensionable earnings". There are specific rules in California State Law and in recent Court rulings that define what type of earnings qualify as pensionable earnings.

The County Employees Retirement Law (California State code sections 31450 through 31899) is the body of law governing the defined benefit County Retirement Systems. This body of law is commonly referred to as the 1937 Act and the twenty county retirement systems operating under its rules are commonly referred to as the 1937 Act county retirement systems. The 1937 Act defines pensionable earnings broadly to mean cash paid to an employee.

In 1983, a California Court of Appeal ruled that pay items to be included in pensionable earnings should be limited to only those items of compensation uniformly paid in cash to all members in a given employment classification. Under this ruling, the Court excluded from the calculation of retirement benefits compensation such as bilingual pay, educational

incentive pay, shift and assignment bonuses, and automobile allowances, and other additional pay that was not provided on a uniform basis to all employees in a designated classification, but was paid only to employees who had special qualifications or assignments or met other special conditions.

As such, the employers routinely paid moderate base pay to all employees and offered additional compensation through skill or duty-based pay. For example, a specific sheriff deputy being awarded additional compensation based on shooting proficiency or a specific social services worker being paid additional compensation for using their bilingual skills. This additional compensation was not considered pensionable earnings and was appropriately excluded from the pension benefit calculations.

In a decision that became final on October 1, 1997, the California Supreme Court in Ventura County Deputy Sheriffs' Association v. Ventura County Employees' Retirement Board 16 Cal.4th 483 (“Ventura Decision”) ruled that the earlier interpretation of the Court of Appeal was incorrect on this point, and that cash payments to the employee as remuneration for services rendered other than pay for time worked except overtime and cash paid to third parties, must be considered pensionable earnings for the purposes of calculating retirement benefits for County retirement systems.

Following the Ventura Decision, the LACERA Board of Retirement evaluated the participating employers' pay items to determine whether such compensation would be considered pensionable earnings. Their findings were documented by Board Resolution and communicated to the employees and participating employers as rules for communicating pensionable earnings to the retirement system. The list of pensionable earnings and those pay items considered not pensionable is available for public viewing through LACERA.com.

Combating Pension Spiking

Pension spiking is the ability for an employee or employer to artificially increase the employee's pensionable earnings used for calculating pension benefits. The 1937 Act code section 31461.45 specifically identifies the pensionable pay items for Los Angeles County and the collective bargaining process for making changes to such list. LACERA expends considerable resources to ensure the participating employers limit pensionable earnings only to those pay items approved by the LACERA Board of Retirement and agreed to through the plan sponsor's collective bargaining processes.

LACERA's first line of protection against pension spiking is the Board of Retirement review of new pay codes to determine pensionability. The generation of new pay codes results from the collective bargaining process between the plan sponsor and their employees. These pay codes are reviewed by LACERA legal staff in relation to the Ventura Decision. The legal analysis is provided to the LACERA Board of Retirement for their determination. The pensionability/nonpensionability of the new pay items is communicated to the plan sponsors so they may update their payroll systems.

LACERA's second line of protection against pension spiking comes from the computer system edit of all payroll transmissions received from the plan sponsor. Exceptions are

investigated prior to updating to the retirement system data bases. These efforts are critical in the building and maintaining employee salary data bases used for the calculation of employee benefits, calculation of age-based employee contributions, and the valuation of plan liabilities.

The third line of defense is the manual audit of member accounts prior to retirement. The members' pensionable earnings are reviewed for unusual items or trends. In the event an error in a member's pensionable earnings is found, the 1937 Act (code section 31539) requires the error be corrected and the member only receive the retirement benefit as defined in California State law. This may require reducing a retiree's retirement benefit prospectively, repayment of over withheld employee contributions to the retiree, or seeking repayment of overpaid pension benefits. The majority of adjustments are effected prior to the employee's retirement.

Some argue that pension spiking extends to the employee's ability to use the employer's compensation structure to maximize their retirement benefit and that such maximization is beyond the pension benefit promised by the employer to the employee. For example, the employee sells unused vacation time back to the employer for cash, thus, increasing their pensionable earnings. No one argues that the employee did not earn the compensation. What is argued is that the employee is not paying their fair share of the pension cost by elevating their pensionable earnings only in the final year of employment prior to retirement. This specific practice is mitigated by Los Angeles County through capping the amount of benefit leave balances that the employee may accrue and convert to cash at a later time.

People's Advocate Pension Spiking Pay Item Listing

The People's Advocate, Inc. is self described on their website as a non-profit entity dedicated to educating the public regarding issues of taxation, government spending, financing, and local, state, and national government structures. The People's Advocate promulgated a list titled "pension spiking". The list infers that all the pay items are used to spike pensions. This is simply not the case. The following is a reproduction of the list with additional information on the pensionability for such pay items for Los Angeles County.

People Advocate List of Pay Items	Pensionability for Los Angeles County
1. Regular Base Pay	Pensionable. Base pay is the foundation for the calculation of pension benefits. Defined in California State Law code section 31640.
2. OT hours paid over a maximum	Not Pensionable. All forms of overtime are excluded from pensionable earnings.
3. Worker comp temp disability	Not Pensionable. Worker compensation awards and short-term disability payments are not pensionable.
4. Shift differential	Pensionable under the Ventura Decision.
5. Special pay allowances	Pensionable. Employees who are working duties beyond the job they were hired to perform receive additional compensation.

People Advocate List of Pay Items	Pensionability for Los Angeles County
6. Incentive pay allowances	Pensionable under the Ventura Decision. Use of incentive pay is common in the private labor market and is beginning to gain more acceptance with public employers.
7. Miscellaneous allowances based on % of base pay.	Pensionable. Cash compensation, such as longevity pay bonus, that is a percentage of base pay is pensionable.
8. Management Differential	Not applicable to Los Angeles County.
9. Retirement Offset (employer's pick-up of employee's share of pension costs)	Not Pensionable.
10. Leave balance usage	Pensionable. Employee compensation that is paid during vacation, sick, and holiday time is considered pensionable.
11. Insurance subsidy	Not Pensionable.
12. Insurance subsidy offset (employer's pick-up of employee's share of costs)	Not Pensionable.
13. Mental health retention	Not applicable to Los Angeles County.
14. Disability pay	Not Pensionable. Safety members being paid by the employer under Labor Code 4850 will have employee contributions deducted from earnings and such earning are pensionable.
15. Pay in lieu of temporary disability	Not applicable to Los Angeles County.
16. One time bonus	Pensionable under Ventura Decision. Lump sum bonus payments may significantly inflate an employee's pensionable earnings if earned during the final compensation period.
17. 7/12 work shift	Not applicable to Los Angeles County.
18. Standby pay	Not Pensionable.
19. Food allowance	Not applicable to Los Angeles County. Reimbursements for food are not pensionable.
20. Clothing allowance	Pensionable under the Ventura Decision.
21. Equipment Allowance	Pensionable under the Ventura Decision.
22. Animal Allowance	Pensionable.
23. Auto Allowance	Pensionable under the Ventura Decision. Auto allowances were significantly curtailed by the plan sponsor in the 1990's.
24. Vacation cash-in	Pensionable under the Ventura Decision. Plan sponsor mitigates the impact through capping the amount of vacation time that may be cashed in by the employee. Employees may only sell back earned vacation that is accrued beyond a preset limit.
25. Payoff of vacation beyond maximum accrual	Pensionable under the Ventura Decision, see above.

In addition to the foregoing list, People’s Advocate also listed “other abuses” in their Pension Spiking paper. The following is clarification on applicability to Los Angeles County.

People Advocate List of Pay Items	Pensionability for Los Angeles County
1. Bargain purchase of service years. Workers are allowed to purchase additional years at prices set before anticipated bonuses, raises, and or plan amendment increases.	Employees may purchase up to five additional years of service credit by paying the full actuarial value of the benefit. These costs are based upon the employees pay rate at time of purchase. Other public agency service credit may also be purchased at the full actuarial value provided the employee is not eligible to receive a retirement benefit from the former public agency based upon such service credit.
2. Reinstatement of Service. Retirees can return to work if they retired before benefits were increased and receive higher pension formula on all previous years.	Not applicable to Los Angeles County. Retirement benefit formulas have never been increased.
3. Retire with one employer that has a CalPERS plan and work full time for another employer who is a 1937 county, or a local agency with an independent plan, or vice versa. This is a common way for safety workers to receive retirement at a greater than 90% of final wages after they have worked 30 years for a single employer.	LACERA will retire any employee who terminates service and meets eligibility requirements. New employees hired by plan sponsor may include employees with public or private employment history. It is becoming more common for employees to choose government employment as a second career.
4. Opt out of employer-provided health insurance and go on spouses plan in final year. Employers commonly pay cash in lieu of health benefits to those who do not enroll in their health plan, and this amount is sometimes included in final pay for pension purposes.	Unspent cafeteria plan contributions received in cash by the employee are non pensionable for employees hired on or after January 1, 1996.
5. End of career promotions for upper management positions.	Promotional opportunities are provided to employees throughout their careers. Employers seek the best qualified candidates irrespective of age and length of service.

As you can see, the LACERA retirement plan is administered to protect the employee’s promised benefit. I trust the information provided herein sheds light on the misleading nature of the People’s Advocate Inc.’s Pension Spiking paper.

Sincerely

GREGG RADEMACHER
Chief Executive Officer

**CalPERS Response to
“Thirty Ways to Spike Your Pension” Document**



Memorandum

California Public Employees' Retirement System

Date: September 14, 2007

To: Tom Branan
Post-Employment Benefits Commission

From: Ken Marzion, Assistant Executive Officer
Actuarial & Employer Services Branch

Subject: Pension Spiking

Tom,

Attached you will find CalPERS' response to the document referred to as "30 ways to spike your pension." Attachment A describes the laws, regulations and policies CalPERS uses to control pension spiking. Attachment B is the list provided by Mr. Costa and Attachment C specifically addresses each item listed in Attachment B. As you'll notice, many items listed on Attachment B are non-reportable items for CalPERS purposes. For those items listed on Attachment B that are reportable to CalPERS, there are many checks and balances in place to make sure pension spiking does not occur.

After reviewing the attached information, please call me and we can further discuss the information provided. Thanks for the opportunity to set the record straight.

CalPERS' Response to
"30 Ways to Spike Your Pension"
prepared for
Public Employee Post-Employment Benefits Commission
Attachment A

CalPERS-Sponsored Legislation Curtails Pension Spiking.

Retirement benefits are calculated as a percentage of "final compensation" that has been reported to CalPERS. So-called spiking is the intentional inflation of "final compensation" in order to increase retirement benefits. In 1993, CalPERS sponsored legislation (SB 53, Stats. 1993, Ch. 1297) defining compensation such that today it is more difficult to include additional amounts in final compensation in order to "spike" a retirement benefit.

Compensation Review and Field Audits Provide Additional Safeguards against Pension Spiking.

In addition to the provisions in the law that define compensation and thereby control the payments counted in the retirement benefit calculation, CalPERS has established a Compensation Review Unit whose job it is to review the retirement benefits and final compensation of newly retired members for the purpose of identifying and correcting mistakes and spiking abuses. Subsequent field audits also may identify situations where overpayments of retirement benefits may be occurring.

As a further safeguard against spiking, whenever CalPERS discovers that erroneous payments have been made to a retired member, CalPERS has an obligation to correct the error. In cases where the overpayment is the result of fraudulent reports for compensation made by a member for his or her own benefit, then CalPERS has ten years from the date of discovery to collect. [Gov. Code sections 20160 *et seq.*]

Definition of Compensation Rewritten and Clarified.

Compensation is payment to employees for services performed during normal working hours or for time during which the employee is excused from work (i.e. holidays, sick leave, vacation, leave of absence, etc.). An employer must identify and *report* compensation for the pay period in which the compensation was *earned*, and the amount reported cannot exceed *compensation earnable*. Overtime compensation is excluded. [Gov. Code sections 20630, 20635, and 20635.1] *Final compensation* (the amount used to calculate the pension benefit) is a member's highest average full-time monthly compensation earnable (i.e. payrate and special compensation) for a 1-year or 3-year period. State and school members use 1-year final compensation and local public agency members use either 1-year or 3-year final compensation period as determined by the employer's contract with CalPERS. [Gov. Code sections 20035-20043, 20635, and 20635.1]

Compensation Earnable includes Payrate and Special Compensation.

Compensation earnable is made up of payrate and special compensation. *Payrate* means the normal monthly rate of pay of the member, and *special compensation* includes only those

payments received for special skills, knowledge, abilities, work assignments, workdays or hours or other work conditions that are listed in statute or regulations. Amounts reported to CalPERS cannot exceed compensation earnable. [Gov. Code sections 20636, 20636.1]

Special Compensation is Limited by Statute and Regulations.

Only those items of special compensation that are listed in Board regulations can be reported as compensation earnable to CalPERS (and thus included in the calculation of retirement benefits). Among the items listed are (i) incentive pay, (ii) educational pay, (iii) premium pay, (iv) special assignment pay, and (v) statutory items. [Cal. Code of Regulations, title 2, section 571] In addition, listed items may only be included in compensation earnable if they are:

1. Contained in a written labor policy or agreement;
2. Available to all members in the group or class;
3. Part of normally required duties;
4. Performed during normal hours of employment;
5. Paid periodically as earned;
6. Historically consistent with prior payments for the job classification;
7. Not exclusively in the final compensation period;
8. Not final settlement pay;
9. Not creating an unfunded liability over and above PERS actuarial assumptions.

Items that may not be included as special compensation include (i) final settlement pay, (ii) payments made for additional services rendered outside of normal working hours, and (iii) other payments the board has not affirmatively determined to be special compensation.

Payrate and Special Compensation Schedules are Public Records.

All payrate and special compensation amounts must be maintained as public records and made available for public scrutiny. [Gov. Code section 20636]

Line-by-Line Response Contained in Attached Chart.

Attachment C identifies relevant statutes or regulations and summarizes the CalPERS procedure for handling each of the thirty spiking events included in “30 Ways to Spike Your Pension.”

Attachment B

PENSION SPIKING

Items included in final compensation for pension purposes (partial list):

1. Regular base pay
2. OT hours paid over a maximum (varies from agency to agency)
3. Workers comp temp disability
4. Shift differential
5. Special pay allowances
6. Incentive pay allowances
7. Miscellaneous allowances based on % of base pay
8. Management differential
9. Retirement offset (employer's pick-up of employee's share of pension costs)
10. Leave balance usage
11. Insurance subsidy
12. Insurance subsidy offset (employer's pick-up of employee's share of costs)
13. Mental health retention
14. Disability pay
15. Pay in lieu of temporary disability
16. One time bonus*
17. 7/12 work shift*
18. Standby pay*
19. Food allowance*
20. Clothing allowance*
21. Equipment allowance*
22. Animal allowance*
23. Auto allowance*
24. Vacation cash-in*
25. Payoff of vacation beyond maximum accrual*

*additional pay added by Ventura decision (2003)

Other abuses:

1. *Bargain purchase of service years.* Workers are allowed to purchase additional years at prices set before anticipated bonuses, raises, and/or plan amendment increases).
2. *Reinstatement of service.* Retirees can return to work if they retired before benefits were increased and receive higher pension formula on all previous years.
3. *Retire with one employer that has a CalPERS plan and work full-time for another employer who is a 1937 county, or a local agency with an independent plan, or vice versa.* This is a common way for safety workers to receive retirement at greater than 90% of final wages after they've worked 30 years for a single employer.
4. *Opt out of employer provided health insurance and go on spouse's plan in final year.* Employers commonly pay cash-in-lieu of health benefits to those who do not enroll in their health plan, and this amount is sometimes included in final pay for pension purposes.
5. *End of career promotions for upper management positions.*

Source: People's Advocate, Inc. 2007

CalPERS' Response To "Thirty Ways" Presented In Attachment B

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
1. Regular Base Pay	<p>Section 20636(b)(1) states: " 'Payrate' means the normal monthly rate of pay or base pay of the member paid in case to similarly situated members of the same group or class of employment for services rendered on a full-time basis during normal working hours, pursuant to publicly available pay schedules. 'Payrate,' for a member who is not in a group or class, means the monthly rate of pay or base pay of the member paid in cash and pursuant to publicly available pay schedules, for services rendered on a full-time basis during normal working hours, subject to the limitations of paragraph (2) of subdivision (e)."</p>	<p>If the position is listed on a publicly available pay schedule and the reported base pay is within the range of the salary listed on the pay schedule, the payrate is reportable to CalPERS.</p> <p>If the position is not listed on a publicly available pay schedule and the agency cannot verify the base pay through an employment contract, the payrate is denied and the member's base pay is reduced to the last verifiable payrate.</p>
2. OT hours paid over a maximum	<p>Section 20635 states: "When the compensation of a member is a factor in any computation to made under this part, there shall be excluded from those computations any compensation based on overtime put in by a member whose service retirement allowance is a fixed percentage of final compensation for each year of credited service. For the purposes of this part, overtime is the aggregate service performed by an employee as a member for all employers and in all categories of employment in excess of the hours of work considered normal for employees on a full-time basis, and for which monetary compensation is paid. If a member concurrently renders service in two or more positions, one or more of which is full time, service in the part-time position shall constitute overtime. If two or more positions are permanent and full time, the position with the highest payrate or base pay shall be reported to this system. This provision shall apply only to service rendered on or after July 1, 1994."</p>	<p>Overtime is not reportable compensation.</p>

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
<p>3. Worker's Compensation Temporary Disability</p>	<p>Section 20630 states: "As used in this part, 'compensation' means the remuneration paid out of funds controlled by the employer in payment for the member's services performed during normal working hours or for time during which the member is excused from work because of any of the following:</p> <ol style="list-style-type: none"> 1. Holidays. 2. Sick Leave. 3. Industrial disability leave, during which, benefits are payable pursuant to Section 4800 and 4850 of the Labor Code, Article 4 (commencing with Section 19869) of Chapter 2.5 of Part 2.6, or Section 44043 or 87042 of the Education Code. 4. Vacation. 5. Compensatory time off. 6. Leave of absence." 	<p>For safety employees: As long as the Worker's Compensation Temporary Disability meets the criteria outlined in Labor Code Section 4850 and Education Code Section 87042 it is reportable to CalPERS.</p> <p>For miscellaneous employees: Worker's Compensation Temporary Disability payments and employer payments in lieu of Worker's Compensation benefits are not reportable to CalPERS. However, if a miscellaneous member uses accrued leave credits, such as vacation, sick leave, or compensated time off, the compensation attributable to the used leave credits are reportable to CalPERS.</p>
<p>4. Shift Differential</p>	<p>Section 20636(c)(1) states: "Special compensation of a member includes a payment received for special skills, knowledge, abilities, work assignment, workdays or hours, or other work conditions." California Code of Regulations (CCR) 571(a)(4) defines shift differential as: "Compensation to employees who are routinely and consistently scheduled to work other than a standard 'daytime' shift, e.g. graveyard shift, swing shift, shift change, rotating shift, split shift or weekends." CCR 571(b) states: "The Board has determined that all items of special compensation listed in subsection (a) are:</p> <ol style="list-style-type: none"> 1. Contained in a written labor policy or agreement; 2. Available to all members in the group or class; 3. Part of normally required duties; 4. Performed during normal hours of employment; 5. Paid periodically as earned; 6. Historically consistent with prior payments for the job classification; 7. Not paid exclusively in the final compensation period; 8. Not final settlement pay; and 9. Not creating an unfunded liability over and above PERS' actuarial assumptions." 	<p>If the shift differential meets the criteria outlined in CCR 571(a)(4) and 571(b) it is reportable to CalPERS as special compensation.</p>

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
<p>5. Special Pay Allowances (For example, Sacramento County Employees' Retirement System's website, Special Pay Allowances is described as "Additional pay for performing work considered to be out of or in addition to the class.")</p>	<p>CCR571 (a)(3) Premium Pay states: "Temporary Upgrade Pay – Compensation to employees who are required by their employer, or governing board or body, to work in an upgraded position/classification of limited duration." CCR 571(b)</p>	<p>If the Temporary Upgrade Pay meets the definition of CCR 571(a)(3) and the criteria of CCR 571(b), it is reportable to CalPERS as special compensation.</p>
<p>6. Incentive Pay Allowances (For example, Sacramento County Employees' Retirement System's website, Incentive Pay Allowances is described as "Additional pay for possession of education degrees or required certificates.")</p>	<p>CCR 571(a)(1) defines all of the Incentive Pay special compensation items that are reportable to CalPERS. The reportable Incentive Pay includes:</p> <ul style="list-style-type: none"> • Bonus • Dictation/Shorthand/Typing Premium • Longevity Pay • Management Incentive Pay • Marksmanship Pay • Master Police Officer • Physical Fitness Program • Value of Employer Paid Member Contributions (EPMC) • Off-Salary-Schedule Pay <p>For example, Sacramento County Employees' Retirement System's website, Incentive Pay Allowances is described as Educational Pay as described in the Public Employees' Retirement Law (PERL) CCR 571(a)(2). CCR 571(a)(2) defines all of the Educational Pay special compensation items that are reportable to CalPERS. Educational Pay includes, but is not limited to:</p> <ul style="list-style-type: none"> • Undergraduate, Graduate or Doctoral Credit • Educational Incentive • Peace Officer Standard Training Certificate Pay <p>CCR 571(b)</p>	<p>If the reported special compensation meets the definition of CCR 571(a) and criteria of CCR 571(b), it is reportable to CalPERS as special compensation.</p>
<p>7. Miscellaneous Allowances Based on Percentage of Base Pay (For example, Sacramento County Employees' Retirement System's website, Miscellaneous Allowances is described as "Assignment differentials based upon a percentage of base pay.")</p>	<p>CCR 571(a)(4) defines all of the Special Assignment Pay special compensation items that are reportable to CalPERS. CCR 571(b)</p>	<p>If the Miscellaneous Allowance is included in CCR 571(a)(4) and meets the criteria of CCR 571(b) it is reportable to CalPERS as special compensation. The labor agreement will be reviewed to determine the amount that is to be reported to CalPERS.</p>

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
<p>8. Management Differential</p> <p>(For example, Sacramento County Employees' Retirement System's website, Management Differential is described as "Additional pay paid to managers in lieu of other benefits, i.e., tuition reimbursement.")</p>	<p>CCR 571 and 571(b)</p> <p>CCR 571(a)(1) Incentive Pay includes:</p> <p>"Management Incentive Pay – Compensation granted to management employees in the form of additional time off or extra pay due to the unique nature of their job. Employees within the group cannot have the option to take time off or receive extra pay. This compensation must be reported periodically as earned and must be for duties performed during normal working hours. This compensation cannot be for overtime, nor in lieu of other benefits excluded under the statutes, nor for special compensation not otherwise listed in this Section 571."</p>	<p>Management Differential, as described by the Sacramento County Employees' Retirement System website, is not reportable compensation. It is not included in the list of special compensation as defined in CCR 571(a) and does not fit the nine criteria listed in CCR 571(b).</p> <p>However, if Management Differential is considered Management Incentive Pay as described in CCR 571(a)(1), it would be reportable to CalPERS as long as it meets the criteria of CCR 571(a)(1) and CCR 571(b).</p>
<p>9. Retirement Offset (Employer's Pick-Up of Employee's Share of Pension Costs)</p> <p>(For example, Sacramento County Employees' Retirement System's website, Retirement Offset is described as "Additional pay for certain employees in-lieu of the county paying _ retirement contributions.")</p>	<p>Section 20691 states:</p> <p>"Notwithstanding any other provision of law, a contracting agency or school employer may pay all or a portion of the normal contributions required to be paid by a member... The payments shall be reported simply as normal contributions and shall be credited to member accounts."</p> <p>CCR 571(a)(1) Value of Employer-Paid Member Contributions states:</p> <p>"The full monetary value of employer-paid member contributions (EPMC) paid to CalPERS and reported as an item of special compensation on behalf of all members in a group or class.</p> <p>The value of EPMC is calculated on all 'compensation earnable' excluding the special compensation of the monetary value of EPMC paid to CalPERS by the employer under Government Code section 20636(c)(4) thus eliminating a perpetual calculation."</p> <p>Section 20692(a) states:</p> <p>"Where a contracting agency employer or a school employer has elected to pay all or a portion of the normal contributions of members of a group or class of employment pursuant to Section 20961, the employer may, pursuant to a labor policy or agreement, stop paying those contributions during the final compensation period applicable to the members and, instead, increase the payrate of the members by an amount equal to the normal contributions paid by the employer on behalf of the employees in the pay period immediately prior to the final compensation period..."</p>	<p>If the value of EPMC is reported to CalPERS as an item of special compensation and meets the criteria as outlined in CCR 571(a)(1) and CCR 571(b), it is reportable to CalPERS.</p> <p>If a contracting agency includes the benefit provided under Section 20692, the employee's payrate is increased by an amount equal to the normal contributions paid by the employer on behalf of the employees during the final compensation period. This increased payrate is reportable to CalPERS.</p> <p>A contract amendment, resolution or ordinance of the governing body must be provided to CalPERS indicating the group or class, effective date, and percent or amount of EPMC being paid and reported as an item of special compensation. The contract amendment, resolution or ordinance must be formally adopted by the employer's governing body, and submitted to CalPERS.</p> <p>The full terms of the contract amendment, resolution or ordinance by which the employer's governing body elects to pay and report the value of EPMC as an item of special compensation — along with any time-include exception for newly-hired employees — must be incorporated into the written labor agreement that pertains to the affective group or class of employment.</p>

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
10. Leave Balance Usage	Section 20630	If the employee is using leave balances in absences from work, that is reportable as compensation.
11. Insurance Subsidy (For example, Sacramento County Employees' Retirement System's website, Insurance Subsidy is described as "Cash payment of the amount of the county contribution towards health insurance over the premium, less the cost of social security.")	Section 20636 CCR 571	Insurance Subsidy, as described by Sacramento County Employees' Retirement System's website, does not meet the definition of payrate or special compensation, and therefore, not reportable to CalPERS.
12. Insurance Subsidy Offset (Employer Pick-Up of Employee's Share of the Cost) (For example, Sacramento County Employees' Retirement System's website, Insurance Subsidy Offset is described as "An amount paid in January of each year to refund the social security reduction of the insurance subsidy to employees who were at social security maximum.")	Section 20636 CCR 571	Insurance Subsidy Offset, as described by Sacramento County Employees' Retirement System's website, does not meet the definition of payrate or special compensation, and therefore, not reportable to CalPERS.
13. Mental Health Retention (For example, Sacramento County Employees' Retirement System's website, Mental Health Retention is described as "A recruitment differential paid twice a year to employees who work at the mental health facility.")	CCR 571	Mental Health Retention is not reportable compensation. It is not included in the list of special compensation as defined in CCR 571(a) and does not fit the nine criteria listed in CCR 571(b).

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
14. Disability Pay	Section 20630	<p>For safety employees:</p> <p>As long as the Disability Pay meets the criteria outlined in Labor Code Section 4850 and Education Code Section 87042 it is reportable to CalPERS.</p> <p>For miscellaneous employees:</p> <p>Disability Pay is not reportable to CalPERS. However, if a miscellaneous member uses accrued leave credits, such as vacation, sick leave, or compensated time off, the compensation attributable to the used leave credits are reportable to CalPERS.</p>
15. Pay In Lieu of Temporary Disability	<p>CCR 570 states:</p> <p>“ ‘Final settlement pay’ means any pay or cash conversions of employee benefits in excess of compensation earnable, that are granted or awarded to a member in connection with or in anticipation of a separation from employment. Final settlement pay is excluded from payroll reporting to PERS, in either pay rate or compensation earnable.</p> <p>For example, final settlement pay may consist of severance pay or so-called ‘golden parachutes’. It may be based on accruals over a period of prior service. It is generally, but not always, paid during the period of final compensation. It may be paid in lump-sum, or periodic payments.</p> <p>Final settlement pay may take the form of any item of special compensation not listed in Section 571. It may also take the form of a bonus, retroactive adjustment to payrate, conversion of special compensation to payrate, or any other method of payroll reported to PERS.”</p>	<p>If an employer pays cash-in-lieu of temporary disability benefits, it is not reportable to CalPERS and the additional compensation will be denied as final settlement pay.</p>
16. One Time Bonus	<p>CCR 571(a)(1) Bonus</p> <p>“Compensation to employees for superior performance such as ‘annual performance bonus’ and ‘merit pay’. If provided only during a member’s final compensation period, it shall be excluded from final compensation as ‘final settlement’ pay. A program or system must be in place to plan and identify performance goals and objectives.”</p>	<p>A One Time Bonus is not reportable special compensation, because it does not meet the nine criteria outlined in CCR 571(b). The bonus that is reportable must be for superior performance and a program identifying goals and objectives must be created in addition to meeting the criteria of CCR 571(b). If the bonus does not comply with CCR 571, the bonus is denied.</p>

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
17. 7/12 Work Shift (For example, Sacramento County Employees' Retirement System's website, 7/12 Work Shift is described as "Regular work schedule of 12 hours per day; 84 hours per bi-weekly pay period.")	Section 20636	All amounts paid for normal working hours must be reported to CalPERS. If the 7/12 Work Shift is the normal working hours for the employees, all amounts paid for hours worked under the 7/12 Work Shift is considered payrate and reportable.
18. Standby Pay	CCR 571	Standby Pay is not reportable compensation. It is not included in the list of special compensation as defined in CCR 571(a) and does not fit the nine criteria listed in CCR 571(b).
19. Food Allowance (For example, Sacramento County Employees' Retirement System's website, Food Allowance is described as "An allowance paid to employees hired or transferred into food service prior to July 1971 represented by Health Services Unit.")	CCR 571	Food Allowance is not reportable compensation. It is not included in the list of special compensation as defined in CCR 571(a) and does not fit the nine criteria listed in CCR 571(b).
20. Clothing Allowance	CCR 571(a)(5) Uniform Allowance "Compensation paid or the monetary value for the purchase, rental and/or maintenance of required clothing, including clothing made from specially designed protective fabrics, which is a ready substitute for personal attire the employee would otherwise have to acquire and maintain. This excludes items that are solely for personal health and safety such as protective vests, pistols, bullets, and safety shoes."	Uniform Allowance is a statutory item and must be reported as special compensation. Employers must report the value of the uniform allowance for employees in positions that require the employee to wear required clothing, such as police officer, bus drivers, etc. Clothing that is not a uniform is not reportable.
21. Equipment Allowance (For example, Sacramento County Employees' Retirement System's website, Equipment Allowance is described as "An allowance paid in two installments to reimburse employees who are required to provide their own equipment, i.e., court reporters.")	CCR 571	Equipment Allowance is not reportable compensation. CCR 571(a)(5) is clear on the definition of Uniform Allowance and does not include items such as protective vests, pistols, bullets and safety shoes. In addition, it is not included in the list of special compensation as defined in CCR 571(a) and does not fit the nine criteria listed in CCR 571(b).

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
22. Animal Allowance	<p>CCR 571(a)(4) Canine Officer/Animal Premium</p> <p>“Compensation to local police officers, county peace officers and school police or security officers who are routinely and consistently assigned to handle, train and board a canine or horse. Compensation shall not include veterinarian fees, feed or other reimbursable expenses for upkeep of the animal.”</p>	<p>If the Canine Officer/Animal Premium meets the definition in CCR 571(a)(4) and meets the nine criteria listed in CCR 571(b) it is reportable to CalPERS as special compensation.</p>
23. Auto Allowance	CCR 571	<p>Auto Allowance is not reportable compensation. It is not included in the list of special compensation as defined in CCR 571(a) and does not fit the nine criteria listed in CCR 571(b).</p>
24. Vacation Cash-In	CCR 571	<p>Vacation Cash-In is not reportable compensation. It is not included in the list of special compensation as defined in CCR 571(a) and does not fit the nine criteria listed in CCR 571(b).</p>
25. Payoff of Vacation Beyond Maximum Accrual	CCR 571	<p>Payoff of Vacation Beyond Maximum Accrual is not reportable compensation. It is not included in the list of special compensation as defined in CCR 571(a) and does not fit the nine criteria listed in CCR 571(b).</p>
26. Bargain Purchase of Service Years	<p>Section 21052 states:</p> <p>A member or retired former employee who elects to receive service credit subject to this section shall contribute, in accordance with Section 21050, an amount equal to the increase in employer liability, using the payrate and other factors affecting liability on the date of the request for costing of the service credit. The methodology for calculating the amount of the contribution shall be determined by the chief actuary and approved by the board. A member or retired former employee electing to receive service credit for service subject to Section 21076 or 21077 shall pay the contributions as described.”</p>	<p>The cost to purchase service credit is based upon the payrate and other factors (benefit formula, special compensation, etc.) that are in effect at the time of the request for costing is made. There is no way to base the cost upon anticipated bonuses, raises or plan amendment increases, because they are not in effect at the time of request.</p>

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
27. Reinstatement of Service	<p>Section 21357(a) states:</p> <p>“For a member reinstated from service retirement or partial service retirement, the current service pension, or current and prior service pensions, as the case may be, upon his or her service retirement subsequent to the reinstatement, shall be the sum of (1) a current service pension calculated on the basis of service rendered after reinstatement in accordance with the formula applicable to him or her in that service and membership, plus, (2) if the subsequent retirement occurs before he or she renders, after his or her reinstatement, at least one year of state service credit under this system, or if the subsequent service or disability retirement occurs after his or her reinstatement from service or disability retirement pursuant to an election under Section 21465, his or her current service pension, or current and prior service pensions, as the case may be, as it was prior to his or her reinstatement...adjusted according to any change after reinstatement in the provisions governing the calculation of his or her pension that would have applied to him or her had he or she continued in retirement but been subject to the formula applied in the first adjustment.”</p>	<p>Scenario:</p> <p>Member retires from Agency A with a benefit formula of 2% @ 55.</p> <p>After member retires, Agency A amends their contract to provide 3% @ 60.</p> <p>Member reinstates with Agency A.</p> <p>If the member works for less than a year after reinstatement, his new allowance will consist of the allowance prior to reinstatement based on 2% @ 55 and an additional allowance based on service after reinstatement date to the 2nd retirement date based on 3% @ 60.</p> <p>If the member works for more than a year after reinstatement, the new allowance will consist of all service credit (prior to reinstatement and after reinstatement) based on 3% @ 60.</p> <p>If the member reinstates with a different CalPERS agency (Agency B) that has a retirement formula of 3% @ 60 regardless of the duration of the new employment, the new allowance will have the service from Agency A based on the 2% @ 55 from Agency A and the service from reinstatement date to the new retirement date with Agency B based on 3% @ 60.</p>
28. Retire From a CalPERS Employer and Work for a 37 Act Employer.	<p>Section 21220 states:</p> <p>“A person who has been retired under this system for service or for disability, may not be employed in any capacity thereafter by the state, the university, a school employer, or a contracting agency, unless the employment qualifies for service credit in the University of California Retirement Plan or the State Teachers' Retirement Plan, unless he or she has first been reinstated from retirement pursuant to this chapter, or unless the employment, without reinstatement, is authorized by this article. A retired person whose employment without reinstatement is authorized by this article shall acquire no service credit or retirement rights under this part with respect to the employment.”</p>	<p>There is nothing in the PERL that prevents someone from retiring from a CalPERS employer and then working full-time with a 37 Act employer.</p>

Pay Type	Public Employees' Retirement Law	CalPERS Procedures
29. Opt Out of Employer-Provided Health Insurance and Go On Spouse's Plan in Final Year	Section 20636 CCR 570	If an employer pays cash-in-lieu of health benefits, it is not reportable to CalPERS and the additional compensation will be denied as final settlement pay.
30. End of Career Promotions for Upper Management Positions	CCR 570	There is nothing we can do to prevent or monitor this. If there is a significant increase in payrate in the final year, the Compensation Review Unit will request documentation from the employer. If the employer informs us that the employee received a promotion, the position is on a publicly available pay schedule, and the salary being reported is within the salary range on the pay schedule, we have no grounds to deny the payrate. We cannot determine whether or not the appointment was a true promotion or not. It is not considered final settlement pay, because it is a promotion and not a pay or cash conversion of employee benefits.

**CalSTRS Response to
“Thirty Ways to Spike Your Pension” Document**

Compensation is credited to the Defined Benefit Program, and therefore includible in final compensation, if it is payable in cash to everyone in the same class of employees for the performance of creditable service and as long as it doesn't meet certain criteria:

- The compensation is paid for the principal purpose of enhancing a member's retirement benefit, as determined by CalSTRS
- The compensation is being paid for a limited period of time
- The compensation is for service in excess of 1.000 years of service in a school year
- There are restrictions in how the employee spends the compensation, or is required to document how it was spent

As a result, the following compensation is creditable to the DB Program:

- Regular base pay
- Management differential (if the member receives release time to perform the management functions)
- Leave balance usage (while the person is employed, not for unused leave at the time of termination)
- Auto allowance

A number of other forms of compensation are creditable to CalSTRS, but are credited to the Defined Benefit Supplement Program (and not the DB Program), a cash balance program whose benefits are measured by the contributions and associated interest credited to those contributions, and are not based on age, final compensation or amount of service. Compensation creditable to DBS include:

- Overtime hours
- Management differential (if paid for work in excess of a normal contract)
- Compensation that is payable in cash to everyone in the same class of employees for the performance of creditable service that meets one or more of the criteria noted above

The remaining compensation listed is not typically paid to DB Program members.

The reason why auto allowances became creditable was to prevent spiking. What happened in the past was that administrators were paid auto allowances during their career and, because that compensation was not creditable, no contributions were paid on it. Toward the end of the career, the auto allowance was converted to creditable salary and contributions began being paid. The resulting increase in final compensation resulted in a lifetime benefit increase that was well in excess of the value of the contributions paid for that limited period of time. By including auto allowances as creditable compensation, there was probably little increase in benefits (because that compensation would have been restructured to make it creditable anyway), but the resulting contributions were more consistent with the value of benefit.

A major tool used by CalSTRS is the school district audit, combined with the provision of law that permits the Board to determine whether particular compensation is being paid for the principal purpose of enhancing the DB benefit. That presumption can only be reversed upon receipt of sufficient evidence to the contrary. By auditing school districts, CalSTRS identifies circumstances in which the employer reported compensation that appears to CalSTRS to be spiking. CalSTRS can require the reporting be reversed to instead credit the specific compensation to the DBS Program, reduce the DB benefit, and require repayment of the overpaid benefit.

Other issues raised by the list:

- **Bargain purchase of service years.** The cost of purchasing service credit is based on the impact of that service credit on the member's DB benefit as of the date of purchase, based on the member's current age and highest compensation in the past three years, even if the service was performed years before at a younger age, lower salary and/or lower benefits.
- **Reinstatement of service.** Retired members may reinstate to active service and receive a new benefit based on plan provisions at the time of the second retirement, if the member works the equivalent of two full years after reinstatement.
- **Retire with one employer with a CalPERS plan and work for a different plan.** This provision does not apply to CalSTRS.
- **Opt out of employer-provided health insurance and go on spouse's plan in final year.** If this restructuring was done in the final year, and was not continued to the replacement person, CalSTRS would likely characterize the change as being paid for the principal purpose of enhancing the DB benefit, and therefore, the compensation would be credited to the DBS Program, and not the DB program, and therefore would not affect final compensation.
- **End of career promotions for upper management positions.** If the member is promoted to a legitimate position with a salary that is consistent with salaries paid before and after that member assumed the position, then it would be creditable for purposes of final compensation. If a position or compensation was established for the member, and was not continued after the member retired, then CalSTRS could determine that the compensation was paid for the principal purpose of enhancing the DB benefit and credit the compensation to the DBS Program, and not have it count toward final compensation.

Appendix 10

Glossary

This section provides a basic definition of terms used throughout the report of the Public Employee Post-Employment Benefits Commission. These definitions are drawn from a variety of sources including:

- California Association of Public Retirement Systems: <http://www.calaprs.org/>
- Governmental Accounting Standards Board (GASB), GASB Summary, 2007: <http://www.gasb.org/>
- Internal Revenue Service, U.S. Internal Revenue Service, 2007: <http://www.irs.gov/>
- International Foundation of Employee Benefit Plans, IFEBP Glossary 11th Edition, 2007: <http://www.ifebp.org/Resources/Glossary/>

115 Trust Fund Account

See Voluntary Employees' Beneficiary Association (VEBA).

401(h) Account

An account established according to Section 401(h) of the Internal Revenue Code (IRC) which permits a pension or annuity plan to provide for payment of benefits for sickness, accident, hospitalization, and medical expenses for retired employees, their spouses, and dependents. Accordingly, the exclusive method for providing medical benefits through a pension plan (or money purchase plan) is by utilizing a Section 401(h) account.

419(a) Plan

A provision of the Internal Revenue Code (IRC) which permits multiple employers to make contributions into a trust which is intended to provide "welfare benefits" to participants in the trust. "Welfare benefits" means insurance such as health, life, disability, and long-term care, as well as severance and education funding.

1937 Act Counties

The 20 California counties authorized by the 1937 Act (California Government Code, Section 31450 et seq.) to establish independent county retirement systems: Alameda, Contra Costa, Fresno, Imperial, Kern, Los Angeles, Marin, Mendocino, Merced, Orange, Sacramento, San Bernardino, San Diego, San Joaquin, San Mateo, Santa Barbara, Sonoma, Stanislaus, Tulare, and Ventura Counties.

Active Member

A member of a pension system who is accruing benefits through current employment.

Actuarial Assumptions

Assumptions made about certain events that will affect pension or OPEB costs. Assumptions generally can be broken down into two categories: demographic and economic. Demographic assumptions include such things as: mortality, disability, and retirement rates. Economic assumptions include: investment return, salary growth, payroll growth, inflation rates, and health care inflation rates.

Actuarial Cost

A cost is characterized as actuarial if it is derived through the use of present values and actuarial assumptions. An actuarial cost is often used to associate the costs of benefits under a retirement system with the approximate time the benefits are earned.

Actuarial Valuation

The procedure used to estimate the present value of benefits to be paid under a plan and to compute the amount of contributions required to cover the normal and unfunded costs of benefits. Actuarial valuations for pension plans are typically performed on an annual basis, and GASB 45 requires that actuarial valuations for OPEB plans be performed at least once every two years.

Actuary

A person professionally trained in the technical and mathematical aspects of insurance, pensions, and related fields. An actuary estimates how much money must be contributed to a pension fund each year in order to support the benefits that will become payable in the future.

Adverse Selection

The tendency of an individual to recognize his or her health status in selecting the option under a retirement system or insurance plan that tends to be most favorable to him or her (and more costly to the plan). In insurance usage, a person with an impaired health status or with expected medical care needs will apply for insurance coverage that is financially favorable to himself or herself and detrimental to the insurance company, also known as anti-selection.

Annual Required Contribution (ARC)

The actuarially determined level of employer contributions that would be required on a sustained, ongoing basis to systematically fund the normal cost and to amortize, over a period not to exceed

thirty years, the unfunded actuarial accrued liability (UAAL) attributed to past service. In other words, the ARC has two components: the normal cost, or the amount needed to pay benefits as they come due, plus the annual amortized amount of the UAAL for both active employees and retirees.

Assumed Rate of Return

An estimate of the annual rate of investment returns to be generated by the fund. This amount is approved by the governing body of the retirement system, and the assumed rate of return has a significant impact on the actuary's estimate of the cost of funding a defined benefit pension plan. An assumed rate of return is also used by an actuary to determine the investment earnings on assets set aside in an irrevocable trust to prefund OPEB liabilities.

Automatic Enrollment

The practice of enrolling all eligible employees in an optional retirement savings plan and beginning participant payroll deferrals without requiring the employees to submit a request to participate in the plan. Plan design specifies how automatic deferrals will be invested. Employees who do not want to make contributions to the plan must actively file a request to be excluded from plan participation. Participants can generally change the amount of pay that is deferred and how it is invested.

Benefit Formula

The formula used to determine the amount of a benefit that an eligible participant receives upon retirement. Each formula specifies a percentage rate based on the member's age at retirement, and either statute or a collective bargaining agreement specifies which formula will be applicable to an individual member. The retirement benefit calculation typically includes three factors: a percentage rate based on the age at retirement and benefit formula applicable to the member, the member's length of credited service, and the member's final compensation. Typically, retirement formulas are titled in such a way as to describe how a retirement benefit would be calculated, such as "2% at age 55." In this case, the retirement benefit for a member retiring at age 55 would be: 2% (the formula percentage) X years of service X average monthly pay rate.

Best Practices

Superior performance by an organization in both management and operational processes.

California Public Employees' Retirement System (CalPERS)

The retirement system established under the California Government Code (Section 20000 et seq.) for state employees, classified (non-teaching) school employees, and employees of California public agencies that contract with CalPERS for retirement coverage.

California State Teachers' Retirement System (CalSTRS)

The retirement system established in 1912 under the California Education Code (Section 22000 et seq.) to provide post-employment benefits for K-12 and community college teachers and school administrators in the State of California.

Cash Balance Plan

A cash balance plan is a defined benefit plan in which an employer credits a participant's account with a fixed percentage of yearly compensation plus interest. Unlike a regular defined benefit plan, the cash balance plan is maintained on an individual account basis, much like a defined contribution plan. The account is credited with a fixed interest rate, regardless of actual investment earnings, and the pension benefit is determined based upon the value of the individual's account at the time of retirement.

Certificated Employee (Schools)

One of two main groups of public school employees, certificated employees are generally teachers, nurses, librarians, and managers with teaching certificates.

Charter City

A city whose form of government is defined by a charter resulting from an establishment convention.

Classified Employee (Schools)

One of two main groups of public school employees, classified employees perform a wide range of functions including food services, maintenance and operations, transportation, instructional assistance, office and clerical work, security, library and media assistance, computer services, and non-certificated management.

Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA)

A federal law that enables former employees to continue health, dental, and vision coverage under their former employer's plans under certain

conditions for a period of up to 18 months following loss of coverage. The employee pays the full premium cost plus administrative costs of 2%. Under state law, medical coverage under the former employer's health plan must be extended an additional 18 months beyond the date COBRA is exhausted.

Contribution Holiday

In years when a retirement system meets or exceeds funding requirements, public employers may not be required to make contributions to the retirement system (i.e., to enjoy a "holiday" from contributions).

Contributions, Employer

Monies contributed to the retirement fund by the plan sponsor for all plan participants.

Contributions, Member

The retirement contributions made by members who participate in a contributory plan. The contribution amount is calculated by multiplying an age-based percentage rate or a fixed percentage rate by the amount of the member's compensation.

Deferred Retirement Option Plan (DROP)

An arrangement under which an employee retires but elects to continue working for the employer and have his or her retirement allowance retained by the retirement fund.

The amount of the monthly retirement benefit that otherwise would be payable accumulates in an account and is credited with interest until the employee separates from employment. During this time, the employee does not accrue any additional service credit as a result of the continued employment. Upon separation, the funds in the individual's account are paid in a lump-sum and the retirement benefits begin being paid as normal.

Defined Benefit (DB) Plan

A plan designed to provide eligible participants with a specified lifetime benefit at retirement. The benefit is based upon the following three factors: a percentage rate based on the member's age at retirement and benefit formula applicable to the member, the member's length of credited service, and the member's final compensation. Defined benefit plans also typically provide disability and death benefits. The plans are funded by member contributions, employer contributions, and income earned from the investment of accumulated contributions.

Defined Contribution (DC) Plan

A plan that provides an individual account for each participant. Benefits are based solely on (1) the actual amount contributed by the participant, as well as any employer contributions made on the participant's behalf, plus (2) any income, expenses, gains/losses, and forfeitures that may be allocated to the participant's account. The account value can increase or decrease due to stock market variations and the performance of chosen investment vehicles. The lump-sum value of the plan is available to the employee upon retirement for annual withdrawals as he or she deems appropriate, but total withdrawals cannot exceed the account balance.

Discount Rate

The rate at which the U.S. Federal Reserve will lend short-term funds.

Early Retirement

A participant's choice to terminate employment and begin receiving a retirement allowance before he or she has reached the normal retirement age. The amount of the participant's retirement allowance is often reduced to reflect the additional years that the retirement allowance will be payable as result of the early retirement.

Employer Pick Up

Pre-tax contributions to a pension system permitted by IRC Section 414(h) which allows member contributions to be made before income taxes are calculated. The contributions reduce the participant's salary but are deemed to be employer contributions.

FASB (Financial Accounting Standards Board)

Independent, non-governmental organization that establishes the standards of financial accounting and reporting in the private business sector for the guidance and education of the public, auditors, and users of financial information.

Final Compensation

Final compensation is a member's average monthly compensation earnable during a consecutive period of time specified by statute or collective bargaining agreement. It is one of the factors used to compute his or her retirement allowance.

Fully Funded

A specific element of pension cost (for example, past service cost) is said to have been fully funded if the amount of the cost has been paid in full. A retirement

plan is fully funded when the funded ratio equals 100% or greater.

Funded Ratio

A ratio of the value of the benefits members have earned compared to the value of the retirement system's assets. While there are many acceptable methods of measuring assets and liabilities, GASB defines the funded ratio as the actuarial value of assets over the accrued liability.

GASB (Governmental Accounting Standards Board)

Independent, non-governmental organization that establishes the accounting standards for state and local governmental entities. The standards of financial accounting and reporting are intended to provide concise, transparent, and understandable financial information.

GASB Statements 43 and 45

GASB Statement Number 43 (Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans) and Statement Number 45 (Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions) establish accounting and reporting standards for OPEB benefits similar to the standards established in 1994 for public employee pension plans. GASB 43 and 45 require governments and plan sponsors to account for and to report the annual cost and the accrued liability of OPEB benefits.

General Law City

A city whose form of government is defined by the laws, rules, and regulations of the state in which it resides.

Government Pension Offset (GPO)

A reduction in the spousal Social Security benefits payable to the spouse or widow of a person who receives a pension from a public retirement system for employment that was not coordinated with Social Security. The reduction may result in no Social Security benefit. Also known as the "spousal offset."

Health Insurance

Insurance product that provides payment of benefits for covered medical services resulting from sickness or injury. Included under this heading are various types of insurance policies, including income replacement products such as accident insurance, disability income insurance, and accidental death and dismemberment insurance.

Health Maintenance Organization (HMO)

A type of health care insurance that offers to its members an agreed-upon set of basic and supplemental health services at specific facilities for a fixed prepaid premium. Usually there are no claim forms.

Health Reimbursement Account (HRA)

Partially self-funded medical and health insurance plans with special tax advantages. Also known as health reimbursement arrangements.

Health Savings Account (HSA)

Tax-advantaged health savings accounts available to those enrolled in a high deductible health plan (HDHP).

Internal Revenue Code (IRC)

The body of law governing tax collection and financial organization provided for under Title 26 of the U.S. Code.

Joint Powers Agreement (JPA)

A separate public agency created by an agreement between two or more public agencies to perform a function common to each (e.g. school districts may create a JPA to provide transportation services for each district). Typically each agency that participates in a joint powers agreement is represented on the governing board of the JPA agency.

Matching Contributions

A contribution made by an employer to a plan on an employee's behalf in an amount equal to an employee's elective or non-elective contributions. The amount of contributions eligible for an employer match is typically subject to a limit established by the employer.

Medical Inflation Rate

The rate of increase of medical costs based on time period comparisons of consumer price indices designed to reflect the costs of medical goods and services.

Medical Reimbursement Plan

An employer plan that reimburses employees for medical expenses directly from employer funds and not through a policy of health or accident insurance.

Medical Savings Account

A savings account that can be used to pay medical expenses not covered by insurance, which is available to employees of small businesses or self-employed individuals who are covered under health

plans with high deductibles. Employers with small group medical savings accounts (MSAs) may make contributions on behalf of employees or employees may make the entire contribution.

Medicare - HMO Plan

A health plan offered by an HMO that has contracted with the federal government to provide managed health care services to individuals with Medicare Part A and Part B coverage. Plan participants agree to receive all services from specified providers, and Medicare, in turn, pays the HMO a monthly fee for each enrolled member.

Medicare - Part A

Hospital insurance that covers inpatient care in a hospital or skilled nursing facility, which also includes hospice care. Medicare Part A insurance is automatic and free for eligible retirees who are fully insured under Social Security and have applied for Social Security benefits, or who have paid sufficient Medicare payroll tax. Members who are not fully insured pay premiums based on the number of Social Security credits they have earned.

Medicare - Part B

Medical insurance that covers physician services, outpatient hospital care, lab services, x-rays, ambulance charges, and some other services not covered by Medicare Part A. Medicare Part B coverage is voluntary, and retirees do not have to be fully insured under Social Security to be eligible. There is a flat premium rate for Medicare Part B coverage.

Medicare - Part D

Medical insurance that covers part of the cost of prescription drugs. Part D was added to Medicare by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 with coverage beginning in January 2006. Unlike coverage provided under Medicare Part A and Part B, Part D beneficiaries must affirmatively enroll in one of a number of available private drug plans during the annual open enrollment period from November 15 to December 31 of each year. While Part D established a standard drug benefit, each plan has a different premium cost and benefits, which may change from year to year.

Medicare - Supplement Plan

An indemnity insurance plan for individuals who are enrolled in both Part A and Part B of Medicare. The plan supplements Medicare coverage by paying Medicare Part A deductibles and copayments, as well as Medicare Part B deductibles and 20% of Medicare-

approved amounts. Supplement plans also often provide coverage for certain items that Medicare does not cover, such as some prescription drugs and care while traveling outside the United States.

National Health Insurance

Any system of socialized health insurance benefits covering all or nearly all citizens, established by federal law, administered by the federal government, and supported or subsidized by taxation.

Nonqualified Plan

An employer-sponsored plan that does not meet the requirements of Section 401(a) of the 1986 Internal Revenue Code and that, as a result, suffers distinct disadvantages from a tax standpoint.

Normal Cost

Computed differently under different actuarial cost methods, a plan's normal cost represents the present value of benefits that have accrued on behalf of the members during the current plan year.

Normal Retirement Age

The age established in a plan's provisions when members become eligible for full benefits, without reduction for age, within that plan. For example, age 60 in a "2% @ age 60" formula.

Other Post-Employment Benefits (OPEB)

OPEB benefits include post-employment health care, as well as other forms of post-employment benefits (for example, life insurance or dental benefits) provided separately from a pension plan.

Pay-As-You-Go

A method of recognizing benefit costs only as benefits are paid. Under the "pay-as-you-go" method, no funds are set aside to prefund benefits and, therefore, no investment earnings are available to offset the cost of those benefits.

Pension Benefit

A benefit payable as an annuity to a participant or beneficiary of a pension plan.

Pension Spiking

The practice of increasing a member's retirement allowance (without a change in plan benefits) by increasing final compensation or including various non-salary items (such as unused vacation pay, mileage pay, uniform allowance, or other allowances) in the final compensation figure used in the member's

retirement benefit calculations and which has not been considered in prefunding of the benefits.

Plan Sponsor

The agency or entity that establish the pension plan, which may include private businesses acting for their employees, state and local agencies operating on behalf of their employees, unions acting on behalf of their members, and individuals representing themselves.

Post-Retirement Benefits

All forms of benefits provided by an employer to its retirees.

Prefunding

A method of funding in which assets are deposited in advance of the actual need to pay the cost of benefits. This is the alternative to "pay-as-you-go" funding.

Public Employees' Medical and Hospital Care Act (PEMHCA)

Directs the administration of the CalPERS Health Program. It is part of the California Government Code, Section 22751 et seq. PEMHCA is sometimes used as a reference to the CalPERS Health Program which provides health benefit coverage for state employees and retirees, as well as the employees and retirees of California public agencies or school districts which contract with CalPERS for that purpose.

Qualified Plan

Plans established under Sections 401(k), 401(a), 403(b), or any other retirement plan that meets IRS criteria allowing employers to deduct pension costs as a business expense, deferring current income tax on plan earnings, and deferring employees' individual income tax on employer and employee contributions.

Reciprocal Agreement

An agreement between two public retirement systems to arrange for the coordination of the pension benefit earned by a member with service credit in both systems.

Rule of 80

The "Rule of 80" can be used as criteria for determining whether an employee is eligible to receive an employer-provided retirement benefit. Under this rule, the sum of the employee's age and number of service must equal 80 in order to qualify for the benefit.

Safety Member

A safety member is defined by statute or plan provisions and generally refers to a permanent employee working in a job related to preserving the public's safety, such as a firefighter or law enforcement officer.

Self-Funding

A plan in which no insurance company collects premiums and assumes risk. Instead, the employer acts in lieu of an insurance company by paying claims with the money ordinarily earmarked for premiums. There are two standard self-funding techniques that are generally used: 501(c)(9) trust and disbursed self-funded plan. An employer self-funding benefits will also need to hire an entity to perform administrative service (such as issuing information to participants and paying claims) or develop the capability to perform those services itself.

Service

Employment taken into consideration under a pension plan. "Past service" refers to service already rendered by the employee.

Service Credit

Length of time, counted in pay periods, months, or other measurement, that an employee performs service. Service credit is one element of a defined benefit plan's formula for determining the amount of pension benefits.

Service Retirement

A retirement based on longevity of employment. A minimum age for a service retirement is established by plan provisions.

State Association of County Retirement Systems (SACRS)

An association of the 20 California county retirement systems operating under the County Employees Retirement Law of 1937. See 1937 Act Counties.

Super-Funded

When the actuarial value of assets exceeds the present value of benefits, a retirement plan is deemed to be "super-funded." In other words, the funding ratio of the plan is greater than 100%.

Third-Party Administrator

An entity hired to perform the administrative services of an employee benefit plan, which may include the collection of premiums and the payment of claims. A third-party administrator is neither the plan sponsor nor a participant of the plan.

Three-Legged Stool

Theory that a combination of an individual's personal savings, Social Security benefits, and pension should be considered when planning for income security in retirement.

Unfunded Actuarial Accrued Liability (UAAL)

The amount by which actuarial accrued liability exceeds the actuarial value of assets; or, in other words, the present value of benefits earned to date that are not covered by plan assets.

Vested Benefits

Benefits to which an employee is entitled under a pension plan by satisfying specified age and/or service requirements. A member with vested benefits retains a right to the benefits he or she has accrued (or some portion of them) even if employment under that plan terminates before retirement, except if the member withdraws his or her contributions. Employee contributions are always fully vested.

Voluntary Employees' Beneficiary Association (VEBA)

As defined in Section 501(c)(9) of the IRC, a separate organization "providing for the payment of life, sickness, accident, or other benefits to the members... or their dependents or designated beneficiaries." Subject to specific rules and limitations, an employer may establish a VEBA to which it makes tax-deductible contributions. The VEBA invests and accumulates funds for the purpose of paying benefits to employees on a tax-exempt basis.

Windfall Elimination Provision

A reduction in Social Security benefits applicable to a retiree who worked for a public employer where Social Security taxes were not paid and who also worked in other jobs long enough to qualify for a retirement or disability benefit under Social Security. A modified formula is used to calculate the Social Security benefit amount, resulting in a lower Social Security benefit than otherwise would have been paid.

Appendix 11

Acknowledgements

The Public Employee Post-Employments Benefits Commission (PEBC) extends its gratitude to the many Californians who provided valuable input to us through the Commission hearings, PEBC website, letters, and other written comments. The following individuals and organizations provided comments and recommendations to the Commission.

Carol D. Adamek-Flaton, California School Employees Association (Retiree)

Scott Adams, American Federation of State, County, Municipal Employees, AFL-CIO

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Gail Beal, Senior Vice President, Keenan Associates

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Ralph Bicker, Retired Public Employees

Fran Blackney, California Foundation for Fiscal Responsibility

Bob Blough, San Bernardino Public Employees Association

Robert A. Blum, Hanson, Bridgett, Marcus, Vlahos, & Rudy, LLP

Patrecia C. Bollin, California School Employees Association

Christy Bouma, California Professional Firefighters

Judy Boyette, University of California

Morgan H. Brown, California Teachers Association Retirement Committee

Tim Callahan, Federated City Employees Retirement Board

Lila E. Cann, CSEA Retiree

Michael Carter, Chief Operations Officer, State Controller's Office

Pam Chapin, Senior Manager, Benefits, and HR, California State University

Yves Chery, Los Angeles County Employees Retirement Association, Trustee/Los Angeles County Probation Officer

Andy Coltart, Retired Public Employees Association

Cinda Combs, Retired Employees Association of Orange County

Stan H. Coombs, Retired Employees of San Diego County

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Ted Costa, People's Advocate

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Shaun Dufosse, Sonoma County Law Enforcement Association

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Jerilyn Harris, Board Vice President, California State Teachers' Retirement System

Lakesha Harrison, President, American Federation of State, County and Municipal Employees, Local 3299

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Phyllis M. Pipes, Newport Mesa California Federation of Teachers Retirement Committee

Rosalie A. Preston, AFSCME, Retired

Carol C. Ramos, California School Employees Association

Irene Ransom, California School Employees Association

Joan M. Raymond, American Federation of State, County and Municipal Employees, Local 127

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Linda L. Robinson, Retired Employees Association of Orange County

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Sara Rogers, Consultant, Senator Sheila Kuehl's Office

Ted Rose, Retired Public Employees Association

James P. Ross, Service Employees International Union, Local 521

Reed Royalty, Orange County Taxpayers Association

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Simon S. Russin, Los Angeles County Employees Retirement Association

Louis Scarpino, Orange County Retired Employees Association & California Retired County Employees Association

Ron Seeling, Chief Actuary, CalPERS

Kathy Shaddox, California School Employees Association

Dr. Mark H. Shapiro, CSU-ERFA/Private Citizen

Keenan Sheedy, Service Employees International Union/Local 721

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Marilynn M. Smith, Service Employee International Union, Local 521

Rowena Smith, California School Employees Association

Tom Smith, Chief Financial Officer, Peralta Community College District

Donna Snodgrass, Vice President, California State Employees Association

Vicki Soderberg, Capistrano Unified Education Association

James A. Spaulding, Retired Public Employees Association

Dwight Stenbakken, Deputy Executive Director, League of California Cities

Richard Stensrud, Administrator, Sacramento County Employees' Retirement System

Roy B. Stone, AFSCME Local 2626, Librarians' Guild

Doug Storm, Retired Employees Association of Orange County

Dom Summa, Assistant Executive Director, California Teachers Association

Terry Sutherland

Keith Tannler, Orange County retiree

Mac Taylor, Deputy Legislative Analyst, Legislative Analyst's Office

Shawn Terris, President, State Association of County Retirement Systems

Leslie L. Thompson, Senior Consultant, Gabriel Roeder Smith & Company

Paul Tutino, Retired Public Employees Association

Jeff Vandersluyveer, Irvine Police Association

Dave Walrath, Legislative Advocate, California Retired Teachers Association

David Wescoe, Administrator, City of San Diego Employees' Retirement System

Larry Yamasaki, SEIU, Local 521

Darroch "Rocky" Young, Former Chancellor, Los Angeles Community College District

Parry Young, Director, Standard and Poor's

In addition, the Public Employee Post-Employment Benefits Commission would like to thank the following organizations for hosting a Commission hearing and for providing planning and logistical support:

**California Teachers Association
CalPERS**

**California School Employees
Association**

California State University-Fresno

**California State Senate Rules
Committee**

City of Oakland

City of San Diego

**Orange County Transportation
Authority**

**Center Park Community Center,
Rancho Cucamonga**

University of California-Los Angeles

University of California-San Diego

The OPEB survey was an involved undertaking where we received help from many different people and organizations, including the following:

Jason Tyburczy, Department of General Services

California Special Districts Association

County Auditors Association

Regional Council of Rural Counties

School Services of California

**State Association of County
Retirement Systems**

California School Boards Association

**California Association of School
Business Officials**

**California County Superintendents
Educational Services Association**

**Association of California School
Administrators**

**California Community Colleges
Chancellor's Office**

And a special thanks to:

League of California Cities

**California State Association
of Counties**

The following individuals were helpful in working with Commission staff on the Case Studies:

Maryanne Achterberg, Payroll Manager, City of Mountain View

Rand Anderson, Manager, Constituent Relations, CalPERS

Mary Balsavich, Administrative Services, Solana Beach School District

Karen Bancroft, Human Resources Director, City of Santa Monica, Santa Monica Medical Trust

Sandy Benson, Chief Fiscal Officer, Solana Beach School District

Charnel Brenner, Retirement Administrator, Marin County Retirement Agency

Linda Brown, Benefits Manager, Encinitas Union School District

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Chuck Conrad, Chief Executive Officer, Alameda County Employees Retirement Agency (ACERA)

Douglas Crancer, Chief of Business & Operations, North Sacramento Elementary School District

Aubrey Daniel, Human Resources Director, Foster City

Demsey, Filliger & Associates, Actuarial Company, Encinitas Union School District

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Candis Hong, Finance Director, City of Thousand Oaks

Terri Klose, Insurance Analyst, Modesto City Schools District

Dick Kurth, Deputy Administrative Services Director, City of Newport Beach, City of Newport Beach Retiree Medical Trust

Pete Kutras, County Executive, Santa Clara County

Larry Layton, Chief Administrative Officer, Trinity County

Bob Locke, Finance Director, City of Mountain View

Jeffrey Markov, Director, Fiscal Services & Management Co-Chair, Elk Grove Benefit Retirement Trust, Elk Grove Unified School District

Mike Martell, City Manager, City of Mountain View

Ken Marzion, Assistant Executive Officer, Constituent Relations, CalPERS

Kevin C. Mascaro, Controller, Western Municipal Water District

Stanley McDivitt, Retirement Administrator, City of Fresno

Jacy Mercer, Deputy Sheriff/Trustee, Central Valley Retiree Medical Trust

Terry Moore, Trust Secretary/Detective, City of Chico Police Department, North State Public Safety Retiree Medical Trust

Tom Moutes, Assistant General Manager, Los Angeles City Employees Retirement System (LACERS)

Clare Murphy, Administrator, San Francisco City/County Retirement System

Kevin J. Murphy, Executive Vice President, Public Agency Retirement Services (PARS), Trinity County

Carey Nethaway, Controller, Sacramento Municipal Utilities District (SMUD)

Dale Nguyen, Senior Management Analyst, Los Angeles City Employees Retirement System (LACERS)

Linda A. Norman, LRR, California School Employees Association, Modesto City Schools District

Brenda Photos, Governmental Affairs, Sacramento Municipal Utilities District (SMUD)

Gregg Rademacher, Chief Executive Officer, Los Angeles County Employees Retirement Association (LACERA)

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Susan Rodriguez, Director, Benefits Administration, Los Angeles Unified School District

Phil Rosentrater, External Affairs Officer, Western Municipal Water District

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