MEMORANDUM
OFFICE OF THE
BOARD OF SUPERVISORS
COUNTY OF PLACER

TO: Honorable Board of Supervisors
FROM: Kirk Uhler, Supervisor District #4
DATE: February 28, 2012
SUBJECT: Amendment of the 2012 Legislative Platform

ACTION REQUESTED
Amend the 2012 Placer County Legislative Platform to support or sponsor legislation and advocacy efforts that would allow Contracting Agencies, such as Placer County to amend its agreement with the California Public Employees' Retirement System ("CalPERS") for a "soft close" of the defined benefit pension plan that would exclude new hires.

BACKGROUND
All new permanent employees hired by Placer County are members of the CalPERS pension plan, and upon meeting vesting and age requirements, are eligible to receive retirement benefits through that system. Current law does not allow contracting agencies to exclude new county employees from the CalPERS defined pension plan although their benefits may be reduced. Highlights of the Public Employee Retirement Law ("PERL") follows:

Statute
The Government Code established the Public Employees' Retirement System with numerous subsequent provisions added through the years relative to benefits, structure, disability, investment, and implementation. Of particular materiality to this discussion, in 1939, the state Legislature passed a bill that allowed local public agencies to participate in the system. Section 20460 provides for participation by any public agency and allows for all or part of its employees members of the system by contract. In turn, section 20281 provides that an employee of a contracting agency becomes a member on the effective date of its contract with the board while every other employee becomes a member upon his or her entry into employment. There are limited exceptions provided in the Government Code to CalPERS membership such as: if the employee assignment is of a temporary nature and limited duration or if the employee is an elected official. Otherwise, all regular full time or part time employee classifications covered by the CalPERS contract are required to enroll at date of hire.

Government Code section 20502 permits an agency to exclude new non-safety hires from the defined benefit plan. However, an agency can only exclude "groups" under this section. Government Code section 20636(e)(1) defines "group" as a number of employees who "share similarities in job duties, work location, collective bargaining units or other logical work-related grouping." Based on this definition, it may be difficult to exclude all miscellaneous employees as one "group." Rather, the County may have to separate the miscellaneous employees into multiple groups based on job similarities.

There are two important limitations in section 20502. First, PERS has the power to veto any proposed exclusions. The County will have to explain to PERS why it should allow exclusion of all future miscellaneous employees from the plan. Second, an agency cannot exclude safety employees under section 20502 or any other provision. Therefore, even if the County were to "soft close" its plan through section 20502, it could only do so for non-safety, future employees. Outside Counsel has recommended that the County not rely on this section to attempt to exclude all new hires, and CalPERS staff have stated that a contracting agency cannot exclude all new hires from the retirement plan coverage.

Finally, section 20475 stipulates that a contracting agency may amend its contract without election among its employees, to reduce new hire pension benefits but does not allow pension benefits for new hires to be entirely eliminated. This section of the Government Code allowed Placer County to implement a reduced retirement benefit formula for new employees hired after March 12, 2011. There are numerous other provisions of PERL that touch on compulsory inclusion of all employees (with some statutory exceptions not applicable here) but the above is illustrative of the statutory roadblocks inherent in trying to eliminate new hires from PERS pension coverage..

DISCUSSION

The Board receives regular updates regarding the performance of the Safety and Miscellaneous Pension Plans up to and including information regarding the County's unfunded liabilities related to these retirement benefits. As recently as January 10, 2012, staff identified the *actuarial value* of the unfunded liability for the pension plans at $273.9 million dollars, with an additional unfunded OPEB liability at $195.8 million dollars. As of these reports, the County's pension plans are estimated to be 74% funded and the OPEB obligation about 37% funded. The rising costs of current employee retirement benefits, including health care insurance costs of $11 million annually, is using a growing share of the County's operating resources.

The defined benefit plan guarantees a lifetime pension benefit to retirees. These promises are difficult for public agencies to maintain since pension investment portfolios were adversely impacted by the severe economic downturn and have not rebounded due to the subsequent, sporadic investment returns. In March 2012 CalPERS will once again review its investment forecast for a possible reduction in the 7.75% discount earnings rate used in the actuarial valuations. Any rate reduction would increase the county's rising pension contributions that resulted from changes in actuarial assumptions, declines in plan funded status, as well as the "smoothing" impacts implemented by the CalPERS Board to spread out significant portfolio gains and losses over a number of years.

If the necessary amendments to the above referenced statutes as well as the other statutes bearing on this issue are enacted, California's Contracting Agencies, including Placer County, could implement a "soft close" to their defined benefit plan and exclude new hires from receiving this benefit. As current employees would not be affected, this could be done without running into vested rights or constitutional issues inherent in changing pension benefits of existing employees. Some impacts of a "soft close" include:

- Lower investment return due to the need to shift assets to investments with a more predictable cash flow; liquidity requirements.
- Accounting impact of amortizing the defined benefit plan expenses over a decreasing payroll; front loaded expenses result in higher operating costs in the short run of about 30-40%.
- Longevity risk due to employee/retiree lifespan uncertainty and the need to accumulate more assets will result in greater cost to an agency in the short term.
- Loss of a recruitment and retention tool.

The requested Board action does not include an option for a Defined Benefit Pension Plan or other system in lieu of participation in CalPERS. Should that be of interest to the Board, additional analysis and research would need to be conducted.

2012 Legislative Platform New Proposal
Amendment of the 2012 Legislative Platform as proposed below would enable Placer County to pursue advocacy for legislation that would allow a "soft close" of the defined benefit plan to new hires. If legislation is approved the Board would need to further consider if implementation should occur in Placer County. This is an extremely complex issue that must weigh fiscal, operational and labor impacts after specific analytical review.

***"Proposal**: "Support or sponsor legislation and policy as may be required to allow Placer County to discontinue enrollment of new employees into the California Public Employees Retirement System (CalPERS) to create a "soft freeze" on the retirement plan; thereby allowing existing employees to continue to accrue service credit and pension benefits within the current CalPERS retirement system. Legislation may also be needed to allow public agencies to amend their CalPERS contract to reduce or eliminate retirement benefits sooner than the current three (3) year requirement. Finally, there may be additional changes needed under Public Employees Hospital and Medical Care Act to allow new hires, not in the CalPERS retirement plan, to have access to the same medical plans as current employees.*

***Issue**: Current law limits contracting agencies, such as Placer County, from being able to control long term pension costs. Essentially, contracting agencies are limited to reducing pension benefits for "new hires" only once every three years and that must be to an established CalPERS formula. Existing law does not allow a contracting agency to establish an alternative retirement benefit for new hires, while maintaining the existing plan participants in the defined benefit plan. The changing dynamics of the workforce, as well as rising pension costs, requires agencies to reassess their current benefit platforms and look at other viable options for retirement benefits for new employees. Modifying existing law to include a "soft close" option would allow contracting agencies another option to use to manage their pension costs and still provide services to constituents.*

FISCAL IMPACT
In FY 2010-11 the County paid $37.7 million toward the two defined benefit pension plans for its employees. This cost included both the employer contribution rate as well as the agreed upon amount of the Employer Paid Member Contribution ("EPMC"), which constitutes the employee share.

As of June 30, 2010 Placer County's defined benefit pension plan liability was in excess of $1 billion dollars. The actuarial value of assets available to fund this obligation was estimated at $798 million dollars (74% funded), with the market value of those assets valued at $627 million (58% funded). To fund this obligation in FY 2012-13, Placer County must provide 19.02% of salary for Miscellaneous and 28.08% for Safety Plan employees to the plan plus the agreed upon county paid employee rate of 6-9%. The most recent actuarial report estimates that employer rates will increase in each of the next two years. Even if Placer County could amend its agreement with "CalPERS" to allow for a "soft close" defined benefit plan, to exclude new hires, these rates will continue to increase.

As current employees retire and the need to create a predictable cash flow for pension payments, the investment portfolio would need to shift to less risk, resulting in a lower investment return. In addition, the accounting treatment would amortize the defined benefit plan expenses over a decreasing payroll; which causes operating costs to increase about 30-40% over the first 5-10 years. Due to lifespan uncertainty, the plan would need to accumulate more assets up front which will result in greater cost to an agency in the short term.