STATE OF CALIFORNIA

PUBLIC EMPLOYEE
POST-EMPLOYMENT BENEFITS COMMISSION

PUBLIC MEETING

Thursday April 26, 2007
10:00 a.m.
Orange County Transportation Authority
600 South Main Street, Room 154
Orange, California

Reported by: DANIEL P. FELDHAUS, CSR #6949, RDR, CRR

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A P P E A R A N C E S

PUBLIC EMPLOYEE POST-EMPLOYMENT BENEFITS COMMISSION

Commissioners Present

GERRY PARSKY, Commission Chair
Aurora Capital Group

MATTHEW BARGER
Hellman & Friedman LLC

PAUL CAPPITELLI
San Bernardino County Sheriff's Department

JOHN COGAN
Stanford University

CONNIE CONWAY
Tulare County Board of Supervisors

RONALD COTTINGHAM
Peace Officers Research Association of California

TERESA GHILARDUCCI, Ph.D.
Trustee
General Motors Retiree Health Pensions

JIM HARD
President
Service Employees International Union Local 1000

LEONARD LEE LIPPS
California Teachers' Association

DAVE LOW
California School Employees Association

CURT PRINGLE
Mayor, City of Anaheim

ROBERT WALTON
Retired (CalPERS)

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A P P E A R A N C E S

PUBLIC EMPLOYEE POST-RETIREMENT BENEFITS COMMISSION

PEBC Staff Present

ANNE SHEEHAN
Executive Director

DEBBIE PRICE

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Public Testimony

W. DARRYL ADAMS
Orange County retiree

STEPHEN C. ANDERSON
Retired

BOB BLOUGH
San Bernardino Public Employees Association

YVES CHERY
Los Angeles County Employees Retirement Association
Trustee/Los Angeles County Probation Officer

CINDA COMBS
Retired Employees Association of Orange County

DAVE ELDER
Self

ROBERT GRIFFIN
Retired Employees Association of Orange County

GAYLAN HARRIS
Retired Employee, Orange County

BILL KIRKWOOD
California Retired County Employees Association

MARK MCCURDY
Fountain Valley resident

HERMAN MARTINEZ
American Federation of State, County, and Municipal
Employees/Local 2076

A P P E A R A N C E S

Public Testimony
continued

MICKY MAXWELL
Retired, Orange County

MIKE PADORE
County of Orange, retired

GREGORY PALMER
Anaheim Police Association

KEITH RICHMAN
California Foundation for Fiscal Responsibility

LINDA L. ROBINSON
Retired Employees Association of Orange County

REED ROYALTY
Orange County Taxpayers Association

SIMON S. RUSSIN
Los Angeles County Employees Retirement Association

DR. MARK H. SHAPIRO
CSU-ERFA/Private Citizen

KEENAN SHEEDY
Service Employees International Union/Local 721

DONNA SNODGRASS
Vice President
California State Employees' Association

VICKI SODERBERG
Capistrano Unified Education Association

DOUG STORM
Retired Employees Association of Orange County

KEITH TANNLER
Orange County retiree

JEFF VANDERSLUYSVEER
Irvine Police Association

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A P P E A R A N C E S

Presentations

PAUL ANGELO
Senior Vice President and Actuary
The Segal Company

NICK BERARDINO
General Manager
Orange County Employees Association

JOHN BARTEL
President
Bartel Associates, LLC

DARI BARZEL
Senior Vice President
Moody's Investors Services

GRANT BOYKEN
Senior Research Specialist
California Research Bureau

MICHELLE CZERKAWSKI
Project Manager
Governmental Accounting Standards Board

DENNIS DANNER
Director, Administrative Services
City of Newport Beach

ERIC HALL
Interim Deputy Superintendent
Capistrano Unified School District

JOE KERR
President
Orange County Professional Firefighters

DICK KURTH
Deputy Director, Administrative Services
City of Newport Beach

JOHN M.W. MOORLACH
Orange County Board of Education

A P P E A R A N C E S

Presentations
continued

LESLIE L. THOMPSON
Senior Consultant
Gabriel Roeder Smith & Company

PARRY YOUNG
Director
Standard and Poor's

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1 BE IT REMEMBERED that on Thursday, April 26,
2 2007, commencing at the hour of 10:00 a.m., at the Orange
3 County Transportation Authority, 600 South Main Street,
4 Room 154, Orange, California, before me, DANIEL P.
5 FELDHAUS, CSR 6949, RDR, CRR, in the state of California,
6 the following proceedings were held:
7 --o0o--
8 CHAIR PARSKY: Ladies and gentlemen, let's see
9 if we can begin our program.
10 First of all, I want to apologize for not
11 having quite enough seats for everyone. We have an
12 overflow crowd. We have a room, I think it's Room 103,
13 if people want to have a seat. And if there's not too
14 many people that don't have seats, maybe we can bring in
15 some extras without violating any fire rules.
16 I want to thank Curt Pringle and all of our
17 Orange County friends for hosting our session today. As
18 I think we indicated at our first meeting, that we plan
19 to hold Commission meetings throughout the state, and in
20 an attempt to both learn from experts and other
21 interested parties as to how local communities assess the
22 nature of the post-retirement benefits issue that we are
23 trying to address, and at the same time, hopefully begin
24 to educate the public as to the nature of this problem.
25 And so we really thank all of you here in Orange County

1 for hosting us.
2 The agenda today, which has been posted, is
3 quite full. We plan to go with a short lunch break until
4 about 3:00 or 3:30 today, if we can get through this in
5 an efficient way. I'll do my best to try to manage that
6 process.
7 And the focus of today's meeting is, again, to
8 try to make sure that the Commission and the public
9 becomes more acquainted with the issues that we're
10 facing. We have a number of subjects that we're going to
11 address, all of which are outlined in the agenda.
12 I think from an administrative standpoint,
13 we're going to have a public comment period. And we
14 welcome commentary coming from the public.
15 I think we'll hold off on any Commission
16 Members' responses or questions to the public comment.
17 And once we get into our individual presentations, we'll
18 let those presentations go forward, and then we'll give
19 each Commission member an opportunity to raise questions,
20 have a dialogue back and forth. And we'll try to keep
21 to our schedule. I'll try to give an indication of about
22 how much time overall that we'll have. But we'll try to
23 give each Commission member an opportunity to ask any
24 questions.
25 And, obviously, written material that anyone

1 would like to submit, we welcome.
2 Anne, any other commentary, administratively?
3 MS. SHEEHAN: No, that's great. Thanks.
4 CHAIR PARSKY: And with that, we'll move into
5 our Public Comment period.
6 We'll try to do this, given the -- I think
7 there are 24 speakers in all.
8 MS. SHEEHAN: Twenty-four speakers, yes.
9 CHAIR PARSKY: And we'll try to do this -- and
10 keep your commentary to three minutes. I mean, having
11 served with the University of California, I know that
12 keeping this time frame is not the easiest thing in the
13 world. And we don't want to be impolite, but we do want
14 to get through the entire agenda.
15 So our first speaker is Donna -- is it Donna
16 Snodgrass?
17 Please come forward.
18 I'm sorry, any other comments that any
19 Commission Members would like to make before we get
20 started?
21 *(No audible response.)*
22 CHAIR PARSKY: Fine.
23 Please proceed ahead.
24 MS. SNODGRASS: Am I at the right place?
25 CHAIR PARSKY: You can be right there is fine.

1 MS. SNODGRASS: Okay. It's up to you.
2 CHAIR PARSKY: Wherever you're comfortable at.
3 That's fine.
4 MS. SNODGRASS: This is fine.
5 Good morning, Mr. Chairman and Commission
6 Members. My name is Donna Snodgrass. I'm the vice
7 president of the California State Employees' Association.
8 I appreciate an opportunity to testify here today on
9 behalf of our 140,000 members, including state and
10 university workers and retirees.
11 We are pleased that the president of one of
12 CSEA's four affiliates, Jim Hard, SEIU Local 1000, is a
13 member of this important commission.
14 The key points I want to talk about today are
15 not new to any of you, but I think they bear repeating.
16 First, there's no pension crisis in California.
17 CalPERS and the majority of local pension systems are
18 solvent and their assets are growing daily. In fact,
19 CalPERS is now 90 percent funded, with over $230 billion
20 in assets. And some county and municipal plans are
21 100 percent and more funded.
22 Some public pension opponents have tried to
23 manipulate the figures from the years 2000 and 2001, the
24 worst stock market period in the last generation, to
25 argue that there is a pension crisis today. But even

1 The Wall Street Journal says that most pension plans are
2 now healthy.
3 They also keep repeating the myth that public
4 employee pension benefits are extravagant. The average
5 state retiree covered under CalPERS receives a pension of
6 less than $1,700 per month after 20 years or more of
7 state service.
8 Trust me, no one is growing rich on a
9 $20,000-a-year pension.
10 The naysayers somehow never mention the fact
11 that up to 3 out of every 4 dollars in public pension
12 benefits paid by CalPERS and other funds come from
13 investment returns, not taxes. They are also quick
14 to point to San Diego as an example of the so-called
15 crisis. The pension problems in San Diego are not the
16 fault of that pension system but rather the fault of
17 apparent manipulation of that system.
18 If you want to hold up San Diego as a poster
19 child of pension problems, you must also admit that there
20 was apparent mismanagement and misuse of those funds, and
21 that created the problems in the first place.
22 My second point is that there is a problem in
23 health-care costs in California, but it is a problem for
24 everyone, not just state workers and retirees. We need
25 to bring health-care costs down for everyone. Merely

1 shifting the cost burden to state and local public
2 service retirees -- the people who need the health-care
3 benefits the most -- or eliminating those benefits all
4 together is not a solution. It merely creates or
5 exacerbates another problem that already exists.
6 In the meantime, CSEA supports having state and
7 local governments put aside money to pay for future
8 retiree health costs. Prefunding health care now is a
9 prudent and positive step that we can take.
10 My final point is that public employee health-
11 care and pension benefits vary from city to city and
12 county to county. They are, in fact, local issues. Each
13 governmental employer has its own priorities, its own
14 budget, and its own level of service. It would be unwise
15 and unfair to try to impose a statewide solution to every
16 governmental agency.
17 And finally, CSEA urges you to deal separately
18 with the issues of health-care costs and pensions. We
19 urge you to look at the facts, not listen to ideological
20 rhetoric and scare tactics as you develop your
21 recommendation for the Governor and the Legislature.
22 Thank you.
23 CHAIR PARSKY: Thank you very much.
24 Next, we have Herman Martinez.
25 Is he here? Herman Martinez?

1 MR. MARTINEZ: Good morning. My name is Herman
2 Martinez. I'm the president of AFSCME Local 2076 which
3 represents over a thousand eligibility workers or welfare
4 caseworkers for the County of Orange Social Services
5 Agency.
6 My current retirement benefits from the County
7 of Orange is that if I retire at the age of 62 with
8 20 years of service, I'll receive $1,545.94 a month.
9 But I will have to pay $703.72 a month for my medical
10 coverage because our group does not have a retiree
11 medical grant, like 16,000 other County of Orange
12 employees. So to retire for me in Orange County is
13 pretty much out of the question, just like it was for a
14 co-worker in our group who died several weeks ago. This
15 person had cancer. And even though she was eligible, she
16 wouldn't retire because she couldn't afford to pay her
17 retiree medical premiums each month. So instead of
18 retiring and spending her last days with her loved ones,
19 she spent them at the office.
20 It's for reasons like this that the collective
21 bargaining process is so important to organized labor
22 groups, because that's what Local 2076 intends to
23 negotiate next year with the County of Orange to obtain
24 the retiree medical grant for our group so that this
25 doesn't happen to someone in our group again.

1 The collective bargaining process is also
2 important because it addresses the specific needs of
3 employees in their region. So a uniform retirement plan
4 applied to all employees is really impractical.
5 I firmly believe that the State of California
6 and the County of Orange can provide fair retirement
7 benefits to its employees by collectively bargaining with
8 the organized labor groups who represent them.
9 Thank you.
10 CHAIR PARSKY: Thank you very much.
11 Next -- I may not say this last name right --
12 Jeff Vandersylvester.
13 MR. COTTINGHAM: Vandersluysveer.
14 CHAIR PARSKY: Vandersluysveer. Sorry, Jeff.
15 If you're not here, then maybe I could make a
16 mistake.
17 Okay, Jeff is not here?
18 Oh, here he is.
19 Oh, sorry. You were in the overflow room.
20 Sorry. We have to give people enough time to get to the
21 podium.
22 MR. VANDERSLUYSVEER: Good morning. My name is
23 Jeff Vandersluysveer. I'm president of the Irvine Police
24 Officers Association. I'm also a director with PORAC,
25 Peace Officers Research Association of California. I'm

1 president of the Orange County Lodge 5 of the Fraternal
2 Order of Police, secretary of the Southern California
3 Alliance of Law Enforcement, and director with the
4 California Coalition of Law Enforcement Associations.
5 Everyday in California our members are out
6 protecting and serving the members of the community.
7 They're running towards danger instead of away from it.
8 But our system provides for their families, it
9 provides for them, and it's something that's safe and
10 secure.
11 The current system we have is a low-cost,
12 well-maintained system. It's an example for other
13 retirement systems around the world. It provides the
14 ability for us to recruit and retain quality officers
15 to meet the needs and the challenges of tomorrow. But
16 it doesn't do an adequate job when people make false
17 allegations toward the system.
18 The system is not in trouble. It is not in
19 peril as was said before as an example. Our current
20 system has funds over $100 billion. So it's over
21 90 percent funded. 75 percent of the returns come from
22 investments. The rest is split between the employer and
23 the employee. When the employers took vacation -- or
24 they took vacation from making contributions and they
25 used their money for other things, the employees kept

1 making their contributions like they were supposed to.
2 When you have extra money, you're supposed to
3 save and bank it, not spend it on other things.
4 We took steps on top of that to provide for
5 security for tomorrow with retiree health care. In my
6 city, Irvine, we do not have a retiree health-care
7 system, so we implemented a VEBA, a voluntary employee
8 benefit association, to help provide for our future for
9 health care. That made us give up some salary, made us
10 give up some benefits in order to get that.
11 Furthermore, that didn't meet our needs so we
12 implemented our retiree health savings plan, again,
13 giving up some of our salary and benefits to provide for
14 tomorrow rather than relying on someone else to do it for
15 us.
16 We can't turn away from danger like some other
17 professions can. If surgery is too difficult for a
18 doctor, he can refer it to another doctor. If a job is
19 too hard for a contractor, he can refer it to a different
20 contractor.
21 We don't have that luxury. We expect every
22 officer, every public safety employee to be able to
23 handle every situation and not turn away from it.
24 We were promised a secure, fair, and what we
25 believe is a well-earned retirement; and we expect that

1 dream to come true.
2 Thank you.
3 CHAIR PARSKY: Thank you very much.
4 Next, we have Micky Maxwell.
5 Is she in the overflow room, too?
6 MS. MAXWELL: Right here.
7 CHAIR PARSKY: Okay, did I pronounce your name
8 correctly?
9 MS. MAXWELL: That's right, Micky.
10 Good morning. Good morning, thank you for
11 allowing us to speak.
12 My name is Micky Maxwell, and I'm a retiree
13 from the County of Orange, where I started working in
14 1973.
15 You may see my button that says "Retiree."
16 There are a number of us in the audience. But we do not
17 represent fully the retirees. We are the ones who are
18 healthy enough and are financially solvent enough to be
19 able to come here. That is probably not our majority.
20 When I walked in, I saw a sign at the greeting
21 desk that said, "Under Measure M, promises made, promises
22 kept."
23 I think that would be a very good slogan for
24 everybody in government and everybody who is making part
25 of this say and part of this process.

1 You have heard from people who are active, who
2 are actually representing somebody, say they are planning
3 for their retirement.
4 We planned for our retirement, too. And we
5 gave up certain benefits and certain salaries in order to
6 plan for a certain retirement. Once you're retired, to
7 have that pulled out from under you, you can no longer
8 plan. You don't have those options.
9 So I'm speaking against having any retroactive
10 changes for active retirees who are now retired and
11 cannot change their plans for the future, because those
12 have been set in concrete.
13 The last thing that I did want to say is that
14 one of the things that we say in my church, is that
15 two people who may not agree on anything, the things that
16 those two people will agree on is what a third will
17 contribute.
18 Therefore, if the County makes an agreement
19 with a union that represents active employees, not
20 retirees, they can agree on what we retirees should
21 contribute to something that they call an unfunded
22 liability.
23 I don't believe it's an unfunded liability.
24 We are an unfunded obligation, and should not have that
25 obligation met by increases in salaries and agreements

1 between two parties who do not have our interests at
2 heart.
3 Thank you.
4 CHAIR PARSKY: Next, we have Keith Tannler.
5 Keith may be in the overflow room.
6 UNIDENTIFIED MAN: He's on the way.
7 MR. PRINGLE: Gerry, maybe you could pronounce
8 the next person.
9 CHAIR PARSKY: Next after that, we have
10 Dr. Mark Shapiro, if he could be ready, that would be
11 good.
12 But Keith Tannler is next.
13 And after Mark Shapiro, we have Bob Blough.
14 MR. TANNLER: Hello. I'm Keith Tannler. And
15 thank you for this opportunity to speak.
16 I'm also a County of Orange retiree. I was
17 employed in 1971, retired after 29 years, almost 30,
18 counting on the benefits that were promised me in good
19 faith.
20 I have a chronic medical condition. I have
21 chronic pulmonary disease, obstructive pulmonary disease,
22 and require ongoing medical care. So my medical benefits
23 are crucial to my future.
24 Over the past four years, as an example, my
25 cost of health insurance per month increased $150. The

1 health grant portion of my retirement only increased $61.
2 I am paying per month at this point for my
3 insurance for myself and my wife $700 a month of my total
4 grant. Any change in this, if the county decides to
5 reduce their portion of the health grant, is going to
6 affect me extremely adversely. And as the previous
7 speaker indicated, all of those of us who are currently
8 retired count on the county meeting the obligation it
9 promised us.
10 So I just strongly want to make that point and
11 say that I'm sure all of the county -- Orange County
12 retirees expect the county to meet their obligations.
13 We served in good faith for our years of
14 service, and we expect them to do the same to us in our
15 retirement years.
16 Thank you.
17 CHAIR PARSKY: Thank you.
18 Okay, next is Mark Shapiro and then Bob Blough,
19 and then Mike Padore.
20 DR. SHAPIRO: Good morning. My name is
21 Dr. Mark H. Shapiro. I'm a retired faculty member from
22 Cal State Fullerton with 36 years of service. One of my
23 earliest jobs also was a wildland firefighter here in
24 California for the U.S. Forest Service.
25 I agree with all of the speakers that promises

1 made to current retirees and to current employees have to
2 be met. They are moral obligations of the entities that
3 made them.
4 There are some problems that have to be
5 addressed; they should be addressed for people who will
6 be hired in the future. And those are that formulas for
7 the retirement systems have to be actuarially sound.
8 One of the problems that I think has hurt a lot
9 of cities is the reduction in the retirement age for
10 public safety members, from 55 to 50. That's taken a lot
11 of experience out of the system, and it's also raised
12 costs. But to put those back up to 55 must be done in a
13 very, very sensitive manner; but it needs to be done.
14 The possibilities include offering a 30-year
15 career retirement or a 55 age retirement for the maximum
16 percentage to reward people who stay for a long time and
17 end their service early.
18 But I think anything that is done has to be
19 done for future employees, not for present employees or
20 for present retirees. Those are obligations that are
21 moral and have to be met.
22 Thank you.
23 CHAIR PARSKY: Thank you.
24 Bob Blough, and then Mike Padore, and then
25 Vicki Soderberg, I think.

1 Bob?
2 MR. BLOUGH: Good morning. My name is Bob
3 Blough, and I'm here as the general manager for the
4 San Bernardino Public Employees Association, representing
5 nearly 17,000 non-safety public employees in 28 cities
6 from West Covina to Needles, and also 14,000
7 San Bernardino County employees.
8 These are hard-working employees that dedicate
9 their careers and their lives to providing important
10 public services to Californians. These hard-working
11 employees deserve to be able to live independently after
12 giving years of hard work in service to the public.
13 The public retirement systems provide the only
14 security for many of them. Most of these employees are
15 not eligible for Social Security. Many of them are not
16 even eligible for Medicare.
17 The creation of this commission provides an
18 opportunity to work together to ensure fair, stable, and
19 predictable pensions and health care for these
20 hard-working Californians who provide vital public
21 services. We have said to our legislators: Let this
22 commission do its important work. It is important to do
23 it right, not just fast.
24 This commission may provide a way for it for
25 all working Americans, both for retirement security and

1 for affordable health care.
2 Everyone deserves to retire with dignity. All
3 working families deserve the pensions they have been
4 promised. All working families deserve affordable health
5 care. We believe it's time to ensure that everyone has a
6 chance to retire with safety and security.
7 And thank you for your hard work.
8 CHAIR PARSKY: Thank you very much.
9 Mike Padore, and then Vicki Soderberg, and then
10 Gregory Palmer.
11 Okay, Mike?
12 MR. PADORE: Mr. Chairman and chairpersons, my
13 name is Mike Padore. I've worked for the County of
14 Orange for 31 years. I retired in 1998, which puts my
15 hire date back in 1967. And when I signed on in '67,
16 I had a contract with the county. It guaranteed me a
17 defined benefit retirement, and it also guaranteed me
18 paid medical upon retirement. I'm not eligible for
19 Social Security because I opted to work for the county
20 for that number of years, 31 years.
21 The bait and switch has never been an
22 acceptable business practice. And I see where what's
23 going on is headed toward a bait and switch. And I don't
24 think that anyone should engage in that. And I think
25 that's where we're going.

1 The County of Orange in December 1994 -- and, I
2 know, John Moorlach -- he foresaw that that was going to
3 happen -- but we already took our hit. They withheld
4 10 percent of our money, and then the bankruptcy judge,
5 fortunately, returned the money, sans the interest we
6 would have earned. So we've taken a hit there. And over
7 the years, the retirement board has loaned or let's say
8 given to the county bail-out monies in the millions
9 of dollars. We've helped them out.
10 And I heard it mentioned earlier, that we have
11 to keep increasing the benefits to make it attractive to
12 keep people. Well, we did that with Tom Mauk, the CEO,
13 he was going to go to L.A. County. And I'm sure that he
14 got enticed to come back. And that's what happens with
15 our police agencies, of which I worked for, and many
16 agencies to try to maintain or train the best people you
17 can.
18 Thank you.
19 CHAIR PARSKY: Thank you.
20 Vicki?
21 MS. SODERBERG: My name is Vicki Soderberg. I
22 am an English and history teacher in the Capistrano
23 Unified School District. I am also the president of my
24 professional organization, the Capistrano Unified
25 Educational Association, which is a local affiliate of

1 the California Teachers Association and the National
2 Education Association.
3 I stand before you today representing not only
4 the 2,400 teachers in the Capistrano Unified School
5 District, but public school teachers across the state of
6 California. And I do appreciate the opportunity to
7 address this commission. And as you deliberate your
8 recommendations to the Governor, I would urge you to keep
9 four salient points in mind:
10 Number one, first, it's very important to
11 recognize that health care in this country is in crisis;
12 and the costs are going up for everyone. No one should
13 be surprised if the new federal accounting standards show
14 retiree health care going up, but retiree health care
15 itself is not the problem. The real problem is the
16 skyrocketing cost of health care for everyone.
17 Secondly, as previous speakers have told you
18 already this morning, we should not break our promises
19 to our hard-working public employees by eliminating or
20 reducing their health-care benefits.
21 But I have to add, that eliminating or reducing
22 health benefits for new employees, especially in the
23 field of education for new teachers, is not the solution,
24 either.
25 With reasonable advanced planning, the teachers

1 I represent, all of California's teachers, should be able
2 to expect health benefits that they were promised, the
3 health benefits they have earned.
4 When I say "earned," I mean this: In the
5 15 years that I have been bargaining salaries for my
6 teachers in Capistrano Unified, I have seen firsthand how
7 rising health-care costs have increasingly infringed upon
8 my ability to negotiate substantial salary increases.
9 Teachers not only in Capistrano Unified but across the
10 state of California have been forced to trade off
11 substantial salary increases in order to have just barely
12 adequate health-care benefits.
13 And thirdly, school districts across the state
14 are finding it increasingly difficult to compete with
15 private business for the very best and brightest of our
16 college graduates, especially in the field of sciences.
17 It is the promise of secure pensions and retirement
18 health care that allow employers like Capistrano Unified
19 to recruit and retain the very best people. If we
20 shortchange our newly hired teachers and we all went
21 through some kind of two-tiered system of health-care
22 benefits, we only short-change ourselves because we won't
23 have teachers to replace increasingly retiring teachers
24 that we see now in school districts in California.
25 And lastly, as public opinion polls clearly

1 demonstrate, the public at large understands and supports
2 health care for all public employees who serve the
3 community, whether they be local or state employees,
4 firefighters, peace officers, or public school teachers.
5 Lastly, I'd just like to remind the Commission,
6 we should remain focused on the real issue: How is it
7 that we make health care affordable for everyone? We
8 should be holding the executives of the drug companies,
9 the hospitals, insurance companies accountable for the
10 outrageous costs which harm us all.
11 As baby-boomers retire, more people will retire
12 and need health care, because all of us, of course,
13 require health care as we get older.
14 Eliminating or cutting health care for our
15 retired workers when they need it the most is just plain
16 wrong.
17 Thank you for your time.
18 CHAIR PARSKY: Thank you.
19 Gregory Palmer, and then Reed Royalty and
20 Stephen Anderson.
21 First, Gregory.
22 MR. PALMER: Mr. Chairman, Members of the
23 Commission, my name is Gregory Palmer. I'm an active
24 police sergeant and president of the Anaheim Police
25 Association, representing approximately 407 active and

1 189 retired members.
2 We're the front-line public safety members who
3 respond to daily and sometimes life-threatening
4 emergencies throughout the City of Anaheim. Several
5 members of this organization have died in the line of
6 duty or been severely injured doing their jobs protecting
7 the public and our society.
8 This current debate about pensions should not
9 be about public employees versus private-sector
10 employees. It's about protecting the middle class in our
11 society. The current benefits offered to public safety
12 officers today are not some sort of windfall for those
13 who put on a badge and a gun daily. They're a useful and
14 needed recruitment and retention tool to make sure that
15 society is protected by the very best available
16 professional police officers. This is something that the
17 public demands.
18 If this were not true, why are there
19 approximately 12,000 unfilled jobs in law enforcement
20 today in our state? Jurisdictions throughout California
21 are experiencing extreme difficulty in hiring qualified
22 peace officers.
23 Our employees until just recently have
24 contributed between 9 percent and 11 and a half percent
25 of their pay towards their own retirement. Recently,

1 during our last negotiations, the City of Anaheim saw fit
2 to make these payments for our employees in lieu of pay
3 raises. Our city is also experiencing recruitment
4 problems in hiring qualified police officers.
5 When talking with our current officers, I am
6 constantly reminded that their pensions and
7 post-retirement benefits are two very important arenas
8 for them staying in the law enforcement profession,
9 because having a stable workforce is highly desirable,
10 since it takes years to become a productive and
11 knowledgeable officer.
12 In fiscal year 7/1 of '99, the City of Anaheim
13 paid 1.93 percent to CalPERS as the agency rate for
14 safety police members. The employee rate was 9 percent.
15 In 2000, 2001, and 2002, the city enjoyed a
16 holiday. They paid zero percent. And that was during
17 the stock market meltdown. In each one of those three
18 years, the employee paid 9 percent.
19 Back in 1985-1986 the City of Anaheim's rate
20 for police and fire was 23.44 percent. Even though that
21 rate was high, we did not get hit by a pension tsunami,
22 and the rates gradually fell to zero.
23 Currently, our funding ratio is 87.2 percent on
24 a market-value asset basis. And because of recent good
25 returns, our funding ratio is rising and the employers'

1 contribution rates continue to fall.
2 You don't pay your entire house mortgage
3 up-front. It's usually amortized over 30 years. If you
4 pay 87.2 percent of your mortgage upfront, you'd be in
5 pretty good shape for the next 29 years.
6 It's the same with our pension system. The
7 distorted claim of some public officials and newspaper
8 editorial writers that our pension system is unsound is
9 nothing more than political gamesmanship to further their
10 own political goals.
11 It does not make sense to treat a symptom of
12 short-term market swings as a crisis of public finance or
13 to assert that our middle-class public employees do not
14 deserve a dignified retirement after decades of service.
15 Thank you very much.
16 CHAIR PARSKY: Thank you.
17 Reed Royalty, then Stephen Anderson, then
18 Keenan Sheedy.
19 MR. ROYALTY: Good morning, Mr. Chairman and
20 Members. My name is Reed Royalty. I'm president of the
21 Orange County Taxpayers Association.
22 In full disclosure, I want to let you know that
23 I'm also a director of the Orange County Employees
24 Retirement System. But today, I speak purely from the
25 standpoint of the Taxpayers Association.

1 I have three points to make.
2 Number one, I believe the existing benefits are
3 overly generous. Even our own publication here, the
4 Orange County Public Employees Retirement Journal, says
5 that these benefits are too rich by far because of
6 personal greed, wishful thinking, and faulty numbers.
7 Do we need these benefits to attract employees?
8 No. People stand in line and fight to get public sector
9 jobs.
10 Do we need to retain employees? No. As a
11 matter of fact, these benefits have the opposite effect.
12 When the Orange County Board of Supervisors granted
13 2.7 percent at 55, over 800 people walked out the door,
14 retiring early.
15 Do we need it to compensate for the lower pay?
16 No, the Employees Benefits Research Institute says that
17 the public employees generally are paid about $11 an hour
18 more than their counterparts in the private sector.
19 My second point, these benefits are unfair to
20 taxpayers. Public employees from my experience are
21 absolutely as good as people in the private sector.
22 Therefore, they deserve equal benefits. They don't
23 deserve benefits that are two or three times better.
24 Pensions and Investments magazine, another one
25 of our bibles here, says, "Why should public employees

1 have better benefits than the working stiffs paying the
2 taxes?"
3 My third point: There are workable solutions
4 for the future. You can't fix the present, but you can
5 fix the future. We can help ourselves at the local level
6 with ballot measures. For example, we might go for
7 higher employee contributions introducing a tier 2 or
8 a tier 3, or whatever is appropriate in a given
9 jurisdiction. And voter approval of new benefits works
10 very well in San Francisco for everybody's benefit. But
11 these local reforms need help from the state. And that
12 is going to be difficult to achieve because, again,
13 referring to another issue of the Public Retirement
14 Journal, the legislators become, quote, "jellyfish in a
15 suit when they confront union representatives."
16 But we need some sort of a hybrid plan that is
17 enacted or enabled at the state level, something like
18 20 percent DB, 80 percent DC, something on that order.
19 And the most important thing we can do, the biggest
20 saving would be raising the retirement age, say, from 50
21 to 57, for safety, and for 55 to 62 or 65 for general
22 employees.
23 Thank you very much.
24 CHAIR PARSKY: Thank you.
25 Stephen Anderson, and then Keenan Sheedy, and

1 then Yves Chery.
2 MR. ANDERSON: Here's a letter for you. It's a
3 letter that didn't get printed. It's a letter to the
4 Press Enterprise in Riverside.
5 *"I have been forced to suffer through two*
6 *amazing editorials by your paper in which you attempt*
7 *to abuse state pension programs by creating a 'doomsday'*
8 *scenario.*
9 *"Boy, do I have good news for you: There's no*
10 *need for hysteria.*
11 *"CalPERS has bounded back and is over*
12 *90 percent funded. As the market continues to improve,*
13 *100 percent funding may be possible again. At the height*
14 *of the investment market, CalPERS was 132 percent funded.*
15 *What you're talking about occurred in 2002, and*
16 *represents the stock market crash when CalPERS was*
17 *80 percent funded.*
18 *"The Wall Street Journal pointed out this*
19 *January: As the stock market rebounds, so have funds.*
20 *That was in January, folks. CalPERS and other state*
21 *pension systems provides as much as 75 percent of the*
22 *cost of pensions, leaving only 25 percent of the cost*
23 *pensions to be paid by the employer and employee.*
24 *"Another important fact that you have*
25 *overlooked is that, as a percent of payroll costs, the*

1 *state pays less for pensions than it did 20 years ago.*
2 *"Obviously, 2000-2002 were abnormal. However,*
3 *when you take them out over a 20-year span, pension costs*
4 *are more or less amounting to about 20 percent of*
5 *payroll.*
6 *"Since 2003, CalPERS' returns on its*
7 *investments have been 23.3, 13.4, 11.11, and most*
8 *recently, 15.7.*
9 *"CalPERS is implementing a new program to*
10 *decrease the effects of economic downturns. It is also*
11 *encouraging the employers to prepay anticipated*
12 *health-care expenses so the investment earnings can be*
13 *used to offset the rising costs of health care. These*
14 *programs cannot be implemented overnight, but progress*
15 *is being made.*
16 *"Why are you seeking to take reliable pensions*
17 *away from senior citizens, who are one of the most*
18 *vulnerable groups in our society?*
19 *"CalPERS offers a stable retirement, lobbies*
20 *businesses to provide senior services at the lowest*
21 *possible cost. The major contributor to state employees*
22 *pensions is effective and efficient and is willing to*
23 *change to make it the best pension system ever.*
24 *"Why do you want Mexico to be our idol when our*
25 *system is better? Let's control ourselves, then we don't*

1 *drag across the border a pension system that is inferior*
2 *to the one we have. California workers need a good*
3 *retirement system, not just something imported from*
4 *Mexico."*
5 And why do I talk about this? This is the
6 letter that didn't get printed. This is the information
7 that we can't get out to the public. Instead, we have
8 another doomsday scenario. For which president, I'm not
9 even sure.
10 And the last one, we still haven't found the
11 tons of WMD, nor as we talk here, every hour, $10 million
12 goes into that project. $10 million, folks. That's what
13 we ought to be focusing on.
14 However, let me just end with one story, the
15 story for anybody that will remember comes from Victor
16 Franco. And it's about a man and his parrot.
17 And he buys a parrot, and he brings it home and
18 he's going to teach the parrot to talk. So he says,
19 "*Polly wants a cracker, Polly wants a cracker*." He did
20 that for several minutes. It didn't work. He expanded
21 to the afternoons, and finally to the evenings. He did
22 this for several weeks. And then finally he takes the
23 parrot out to the chicken coop and he throws it in and
24 he says, "*Because you don't talk and you act more like a*
25 *chicken than a parrot, you don't stay in the house with*

1 *me in the evenings any longer*."
2 He went to sleep. He gets up in the morning.
3 He goes out and he looks at his lot and all there is is
4 feathers. And as he walks out to see what happened, he
5 sees it comes from the chicken coop. He opens the door
6 and there's a dead chicken here and a dead chicken there
7 and a dead chicken over there. And the parrot is at the
8 end of the chicken coop with the last chicken, saying,
9 "*Polly wants a cracker, Polly wants a cracker, Polly*
10 *wants a cracker*."
11 And I see this is what's happening in our
12 society with not being able to have a fair public hearing
13 or a public fair discussion on this matter.
14 Thank you.
15 CHAIR PARSKY: Thank you very much.
16 Next, Keenan Sheedy, and then Yves Chery, and
17 then Simon Russin.
18 Yes, please, Keenan.
19 MR. SHEEDY: Good morning. My name is Keenan
20 Sheedy. I'm employed in the Patient Financial Services
21 Department at L.A. County USC Medical Center. And I
22 stand before you today as a worker and as a working stiff
23 and a taxpayer. We are all together on that.
24 I'm a member of the Service Employees
25 International Union, Local 721, which represents over

1 89,000 members in Central and Southern California. And
2 I'm the chairperson of the union's Bargaining Policy
3 Committee, which coordinates collective bargaining for
4 over 45,000 Los Angeles County chapter employees and
5 special district employees.
6 Thank you for the opportunity to address the
7 Commission today.
8 In Los Angeles County, we have a process in
9 place to address GASB 45. And we are working together to
10 forge an L.A. solution.
11 What we need now is serious work and
12 cooperation among all the parties involved.
13 Local 721 has been working on retiree health
14 issues since last year. And in 2006 we met with
15 Los Angeles County, and the parties mutually agreed to
16 develop recommendations to mitigate future retiree
17 health-care costs.
18 Earlier this year, the actuaries from the
19 county, from LACERA -- the L.A. County Employees
20 Retirement Association -- and the union agreed upon
21 assumptions to be used in LACERA's actuarial valuation to
22 comply with the GASB 45 disclosure requirements. And
23 since this past January, we have had a joint labor
24 management committee that has been meeting to lay the
25 foundation for addressing GASB 45.

1 Our most recent meeting was Tuesday of this
2 week, and we'll be meeting as frequently as necessary.
3 Both parties are committed to productive and
4 positive solutions and discussions. We will be exploring
5 several different options to address the issue, but in an
6 atmosphere free of panic and destructive rhetoric.
7 From the union's point of view, none of these
8 options will involve cutting any benefits for retirees or
9 current employees; and we are opposed to any two-tiered
10 system which adversely impacts future employees as a
11 couple of the previous speakers have indicated.
12 The health-care system is broken, but it is not
13 the fault of our retirees, nor is it the fault of our
14 current employees. Quality health care is a fundamental,
15 moral, and political question.
16 Fanning the flames of intergenerational
17 conflict is reckless and divisive and will serve none of
18 us.
19 We can craft a solution. We can secure quality
20 health care for our current and future retirees while
21 protecting the critical services we provide for
22 10 million L.A. County residents. That is what the
23 public expects of public servants, and we will meet that
24 obligation.
25 What would not be in the public interest is for

1 a one-size-fits-all cookie-cutter solution in California
2 to this particular issue.
3 L.A. County is unique; and together, we can and
4 will forge an L.A. County solution. And that's what the
5 parties working together in L.A. County intend to do.
6 Thank you.
7 CHAIR PARSKY: Thank you very much.
8 Yves Chery.
9 MR. CHERY: Good morning, Members of the
10 Commission. I'm Yves Chery. I'm a trustee on the LACERA
11 County retirement board association -- I'm a trustee on
12 the County retirement board. I'm also a deputy probation
13 officer. I've been a deputy probation officer for
14 17 years.
15 I'm currently the chair of the LACERA
16 Operations Oversight Committee. There, we deal with
17 administrative issues concerning LACERA. I'm here to
18 urge you to support local control.
19 Since 1982, LACERA has been administering the
20 retiree health plan for retirees of nearly 50,000
21 members. We have currently about 150,000 total members
22 in LACERA.
23 Due to our computerized system, we have been
24 able to provide our retirees with their checks within
25 30 days after they formally retire.

1 Due to our increased outreach program, which I
2 have been a strong advocate of, we have been able to
3 better educate our members by providing educational
4 conferences, seminars to our new members, our mid-career
5 members, our preretirement members, and as well as our
6 retired members.
7 In addition, we have established a
8 comprehensive Web site that our members can use to
9 calculate their pensions, retrieve accurate and current
10 information regarding their benefits, and any further
11 information that will be of benefit to them.
12 As a result, LACERA has saved an enormous
13 amount of money and people power and time.
14 In short, since 1938 LACERA has been working
15 for the employees of L.A. County, the people of L.A.
16 County, and the people of California.
17 As a LACERA trustee and a probation officer, I
18 urge this board to support local control.
19 Thank you.
20 CHAIR PARSKY: Thank you.
21 Simon -- I recognize Simon.
22 MR. RUSSIN: I recognize you, too.
23 My name is Simon S. Russin.
24 I saw Chairman Parsky at the Milliken
25 conference, and I was very disillusioned that the

1 speakers they had at that conference. Mr. Parsky was
2 pretty good, but the fellow from New Jersey was horrible.
3 He attacked everybody.
4 CHAIR PARSKY: We're not letting New Jersey
5 take over California quite yet.
6 MR. RUSSIN: I hope not. But it was really
7 very interesting that he wasn't indicted, I think, for
8 fiduciary breaches. That was my opinion. I don't want
9 to go there.
10 Anyway, I'm Simon Russin. I'm the old-time guy
11 on the L.A. County Board. I've been on the Board of
12 Retirement for 25 years and the Board of Investments for
13 18 years. So I've seen a lot of crises that we go
14 through.
15 And this is, again, just another normal
16 problem. In another five years, things will clear up
17 again, hopefully.
18 But we have a problem. The medical costs are
19 out of control. Our last rates were 8.25 percent for
20 retirees. The county pays out of the General Fund
21 $400 million towards those benefits.
22 If you have 25 years of service, you have full
23 coverage of the base plan. If you're vested, after
24 10 years, which is important for getting some benefits,
25 you get 4 percent back. So we have a wonderful program,

1 we have an excellent program, and we want to keep it.
2 And there has to be some way of keeping this program
3 together, because retirees really rely on it.
4 I don't want to see things happening in other
5 counties where half your paycheck goes to pay for your
6 medical costs. That's just not acceptable. That's
7 awful.
8 One issue I want to bring up is that for local
9 control, instead of state-mandated programs that you
10 might be coming up with is that in 1994 the crisis hit
11 Los Angeles County. We're going to be following Orange
12 County in bankruptcy. And there will be a lot of
13 brainstorming. And what we did at that time is that the
14 county funded a billion dollars through pension
15 obligation bonds to bring the county up to 100 percent
16 funding. And the deal was if we ever made any money, the
17 county would get three-fourths of that and LACERA would
18 get one-quarter. Well, who would ever believe the stock
19 markets took off like they did? And so the county got an
20 additional almost $2 billion that they could use towards
21 retiree contributions. So there was some solution.
22 So what I'm saying is if you take away local
23 control for some of these things, we won't be able to do
24 that.
25 So I'm not sure where else I can go with this

1 thing. I'm not sure how much time I have. But it's a
2 real important thing.
3 Remember that our pensions are constitutionally
4 protected, retiree health care isn't. And that's a big
5 problem. And so I'm not sure where we go from there.
6 But you have a hard job to do. And thank you
7 for letting me speak.
8 CHAIR PARSKY: Thank you very much.
9 Bill Kirkwood, Robert Griffith, and then Linda
10 Robinson.
11 I'm sorry, I didn't alert people.
12 Thank you.
13 MR. KIRKWOOD: Commission Members, I appreciate
14 this opportunity to address you. My name is Bill
15 Kirkwood. I was an employee at Orange County for
16 30 years.
17 I am president of the California Retired County
18 Employees Association. This association represents the
19 20 counties developed under the '37 Act. We currently
20 have over 100,000 members, retirees from every department
21 of the 20 counties.
22 I assumed their responsibility of president
23 because I discovered no one speaks for retirees. The
24 only recourse we have is through legislation, the ballot
25 box, or the courts.

1 Recent events have brought on some real
2 problems.
3 First, double-digit increases in health-care
4 premiums caused immediate financial hardship to
5 fixed-income retirees.
6 Then, coincidentally, unions negotiated
7 enhanced retired benefits for active employees.
8 Then GASB appeared, touting unfunded
9 liabilities. This resulted in headlines that suggested
10 that retiree health care was a problem, and had to be
11 reduced or eliminated.
12 Several counties immediately rushed to change
13 existing health plans, separating retirees from active
14 employees for risk pool purposes.
15 This maneuver reduces costs for actives, but it
16 really increases premiums for retirees.
17 In addition, there are proposals to eliminate
18 health grants that have been in place for years, grants
19 that retirees have depended upon making life choices.
20 These are pretty grim alternatives.
21 We recently concluded a biannual conferences in
22 San Bernardino, and the Counties of Orange, Sacramento,
23 San Diego, Contra Costa, San Bernardino, Sonoma, and
24 Tulare all reported grave concerns due to anticipated
25 reductions in health benefits.

1 I do not mean to minimize the seriousness of
2 state and county financial problems, but it is unfair
3 to balance budgets on the backs of all the retirees whose
4 annual benefit is $20,000.
5 Ladies and gentlemen, there has to be better
6 solutions.
7 Thank you.
8 CHAIR PARSKY: Robert Griffith, and then Linda
9 Robinson, and Gaylan Harris.
10 Robert?
11 MR. GRIFFITH: Thank you.
12 I'm Robert Griffith. I'm a member of the board
13 of the Retired Employees Association of Orange County,
14 retired from the county after 34 years of service.
15 I would like to suggest that the solution to
16 this manufactured crisis of public pensions might lie in
17 taking a long-term view. We have been overwhelmed with
18 various politicians and editorial writers looking at the
19 short-term, and "The sky is falling" and Chicken Little
20 and the rest of that.
21 Looking at a couple of years for pension
22 funding, especially contributions from the employers,
23 does not give you an accurate view of what the real
24 funding of public pensions are any more than back in the
25 nineties, when you remember the PERS contribution

1 holiday. Orange County's retirement system, the County
2 contribution for general members was less than 1 percent
3 during some of that time. That was not an accurate view
4 of the real funding of public pensions, either.
5 It takes a long view to look at what really
6 happens with the funding of public pensions.
7 In a general way -- and the numbers will vary
8 from jurisdiction to jurisdiction a little bit --
9 investment returns fund something usually in excess of
10 70 percent of the cost of the whole pension process,
11 and of the remaining 30 percent, half is contributed by
12 the employer and half by the employee.
13 You remember during the contribution holiday
14 and the low contribution period, private employers, even
15 if they didn't provide a pension -- if all they provided
16 was Social Security -- were still paying 6.2 percent of
17 payroll for their people, when public employers were
18 largely paying virtually nothing.
19 I don't remember a lot of editorial writers
20 going, "Oh, my god, this is terrible" at that time.
21 If we take the longer view, I think it gives us
22 all a little bit of opportunity to take a deep breath and
23 think a little bit further through what the solutions
24 are.
25 One of the problems that probably has to be

1 addressed -- maybe there are mechanisms currently in
2 place, or maybe new legislation needs to happen -- it's
3 a budgetary problem for a local jurisdiction who has to
4 deal with an annual 12-month budget, to have big
5 increases in a particular item like pension funding.
6 There are ways to smooth that over a longer
7 period of time. Maybe more needs to be done, so that it
8 doesn't have the devastating impact on one year's budget.
9 And when things are on the other side, the employer
10 doesn't get complacent, thinking that pensions don't cost
11 him anything, because they clearly do cost even in those
12 years.
13 The big numbers that are often quoted as to
14 what the liability is for the taxpayers needs to be taken
15 with a grain of salt, too. Unlike most private pensions,
16 public pensions, the employee contributes to the paying
17 of that, just as much as the employer does in most cases.
18 It's an equal share, the way the formulas work.
19 And that's often not talked about or not
20 acknowledged in the editorials and by the politicians
21 who want to make tomorrow's headlines with their
22 statements.
23 The last point I'd like to make is that I think
24 this idea of looking at the long-term prefunding being
25 able to provide as much as 70 percent of the cost of the

1 benefit maybe gives us at least part of the solution to
2 the health-care problem also. I think most jurisdictions
3 throughout the state, probably throughout the country,
4 have funded health care for retirees on a pay-as-you-go
5 basis. That's just plain silly. I mean, that's not the
6 appropriate way to do it.
7 So prefunding, putting some money in the pot,
8 letting it generate earnings like the pension funds do,
9 will reduce that overall liability and keep the cost to
10 a manageable level.
11 Thank you.
12 CHAIR PARSKY: Thank you.
13 Linda Robinson, and then Gaylan Harris, and
14 Doug Storm.
15 MS. ROBINSON: Good morning. My name is Linda
16 Robinson. I retired after 41 years of employment, ten
17 in the private sector and 31 in the public sector,
18 working for the County of Orange. I have been a taxpayer
19 for 41 years. I'm a homeowner and I'm a voter.
20 Thank you for the opportunity and for your
21 attention to provide input to the Governor via your
22 commission.
23 I hope this process is real, with no preset
24 agendas determining the outcome of this hearing.
25 We all want reasonable solutions to unfunded

1 liabilities, solutions that are well thought out and
2 which do not have unintended or dire consequences.
3 The Governor's process should be all-inclusive.
4 However, notably missing from the Orange County panel is
5 a retiree spokesperson. This omission hardly assures a
6 complete unbiased, no-spin picture of the county's
7 solution to unfunded retiree medical liability. The
8 failure to include those who are damaged the most speaks
9 volumes.
10 Make no mistake, as it stands today, the Orange
11 County solution to a 30-year, $1.4 billion unfunded
12 medical liability will unduly penalize and harm retirees.
13 For the record, current retirees do not
14 constitute a 1.4 billion-dollar unfunded liability to
15 Orange County taxpayers.
16 For the record, the retiree pool is finite,
17 with an average age of 69. Think about that. Over the
18 next 30 years you will see a drastic reduction in
19 liability as pool numbers depart this earth, perhaps
20 prematurely, given the solution adopted by our prior
21 board of supervisors. And Mr. Moorlach -- where did he
22 go? -- he was not on that prior board.
23 Last fall, that board adopted labor agreements
24 which provided active employees who were well-represented
25 by their unions with significant wage increases in

1 exchange for reduced retirement benefits. Those same
2 reduced benefits were unilaterally imposed on retirees
3 without compensation but with a whopping premium increase
4 many cannot afford, starting just eight months from now.
5 What kind of society and government reneges on promises
6 to its retired senior citizens on an issue as vital as
7 health care?
8 Orange County should be a wake-up call to every
9 current and future retiree in California and in this
10 nation, regardless of whether they work in the public or
11 the private sector.
12 Social Security and Medicare are not
13 predictable safe havens for any retiree. And retirees
14 should be very aware of what their elected
15 representatives are willing to set in motion at their
16 expense.
17 Please do not allow open season on retirees.
18 Retirees did not create this crisis you are attempting to
19 address, and we should not be made a convenient
20 scapegoat.
21 Any support this committee could provide in the
22 plan you will propose to the Governor would be greatly
23 appreciated.
24 Thank you.
25 CHAIR PARSKY: Next, Gaylan Harris, Doug Storm,

1 and then Keith Richard.
2 MR. HARRIS: Good morning. My name is Gaylan
3 Harris. I appreciate this opportunity to speak to this
4 commission and for your coming to Orange County and
5 allowing us to have easy access to you.
6 I spent 35 years working in government, most of
7 that for Orange County. The last 15 years of that career
8 was as the manager of employee benefits and retiree
9 benefits for the County of Orange. We've been working
10 with the county for a couple of years now on their plans
11 and what they're going to do with GASB 45. I want to
12 report that what they have is not an example that anyone
13 else would care to follow.
14 I don't know what medical inflation is going to
15 be, and I really don't think anyone in this room knows
16 what medical inflation is going to be over the next
17 30 years.
18 I do know however that based on the rates the
19 county has given us, the average retiree health plan
20 costs will go up over 90 percent. This is going to drive
21 many retirees out of the coverage. There is no way that
22 they can afford to continue.
23 To give you some examples, Orange County claims
24 to have saved $800 million through their plan that they
25 adopted this last September and October. The average

1 retirement allowance is about $24,000 a year. The impact
2 on retirees will be devastating.
3 I mean, basically what has occurred is costs
4 haven't gone away, they've just been shifted from the
5 public employer and employees to retirees. Those are the
6 individuals that are picking up $800 million worth of
7 liability for the next 30 years.
8 Retirees are facing increases in the
9 least-expensive catastrophic $5,000-deductible plan, from
10 $20 per month currently, to $400 per month. If retirees
11 have a dependent, those costs soar from $180 a month
12 today, to $680 per month.
13 When Medicare costs are added, the
14 out-of-pocket costs go up to over $800 per month. And
15 this is the least-expensive plan.
16 Let's look at some of the other plans and
17 what's going to occur. In the $600 deductible,
18 two-person plan, the costs are going to go to over
19 $19,000 per year. Virtually, the average retirement
20 allowance for Orange County retirees. So they can give
21 their entire check up just to pay the costs of their
22 medical coverage.
23 For some people, there aren't a lot of choices
24 because this is the only plan that's available to them
25 wherever they might live. All the HMOs in Orange County

1 are only available in Orange County. Those are only
2 going up to $14,000 a year. So even that is beyond the
3 realm of possibility for many of the retirees.
4 One of the things that is not mentioned is that
5 the county's -- their cost -- anticipated that
6 100 percent of the individuals will participate in the
7 plan. Today, 52 percent do. That other 48 percent just
8 can't afford it now.
9 The average cost is like $4,000 a year for
10 coverage and people just can't do it.
11 If you retired 20 years ago, you're lucky to
12 be making a thousand dollars a month in retirement. So
13 there's just no way that the math works out that people
14 can keep coverage today.
15 Fortunately, many have Medicare.
16 Unfortunately, many don't have Medicare. And those
17 individuals are particularly hard hit. These individuals
18 are looking at the possibility that because they no
19 longer can get their health insurance with the County of
20 Orange, they're going to have to turn to Medi-Cal. And
21 in order to turn to Medi-Cal, they're going to have to
22 liquidate all their assets just to qualify.
23 Now, this is a heck of a situation that we put
24 people into. And that's what's going to happen if the
25 plan put in motion by the board of supervisors in

1 September, October comes to fruition this next
2 January 1st.
3 Let's talk a little bit about the payment on
4 this. Retirees prepaid cost of health-care insurance by
5 paying 1 percent of their pay into a retiree medical
6 fund. Not only that, but they actually gave up interest
7 earnings that should have been credited to their accounts
8 but were used by the county to support payments to the
9 retirement system. I don't know why in the world a
10 system that generates 10 percent returns on investment
11 will turn around and credit retiree accounts or employee
12 accounts 5 percent. And that's basically what happened.
13 I think that's a theft of funds from the individuals who
14 made the contributions. But that's been a long-standing
15 practice, not just in Orange County but elsewhere.
16 Okay, I believe there are many ideas that are worth
17 looking at that could assist in solving some of the
18 problems. We need to look at the tax advantage
19 approaches. I think health spending accounts, HSAs, are
20 something that need to be looked at. But they have to
21 be funded. You don't just throw a thousand-dollar
22 deductible plan on the back of a retiree and not provide
23 some assistance to them to make that possible to operate.
24 Now, if we could save a third the cost because Uncle Sam
25 will pay for it in the way of tax breaks, let's look at

1 that. This is maybe something that makes a lot of sense.
2 You know, we need to provide transparency of information
3 used to calculate obligations.
4 Right now, it goes into the black hole and then
5 it comes out of the black hole, and retirees have little
6 to say or understanding of what is going on.
7 We need to provide guidance on actuarial
8 methods of calculating liabilities. I've seen numbers
9 double, triple, depending on the organization that you're
10 looking at and the actuary brought into there. And this
11 needs to be a little bit more reasonable and realistic.
12 And the actuaries will probably work it out in 20 years,
13 but I think we can help them along in the process. And I
14 think CalPERS has probably a special role to play in this
15 area. And I think over the years they've done an
16 outstanding job.
17 We need to provide access to funding to prefund
18 retiree medical obligations. People have talked about
19 this before. But if we can look at the difference
20 between the S & P returning 10.4 percent from 1925 until
21 today -- that's a very long period -- compared to the
22 cost of issuing a 6 percent bond today, that 4 percent
23 arbitrage could be incredibly powerful in funding a
24 retiree medical program. And I don't think we should
25 take anything off the table. These are valuable tools

1 that are available.
2 Who knows what that bond market is going to be
3 two years, three years, four years from now. Today, it's
4 very beneficial.
5 I have other items, and I'd be glad to share
6 those if you would like to hear them.
7 Thank you.
8 CHAIR PARSKY: Thank you very much.
9 Doug Storm, Keith Richman, and then W. Darryl
10 Adams.
11 MR. STORM: Good morning, ladies and gentlemen.
12 Thank you for being here.
13 And I would like to compliment the process.
14 This is actually the process that should have occurred in
15 this county, but it didn't.
16 So I'd like to talk just a little bit about the
17 process so that you can take that back and maybe think
18 about it when you write your report.
19 I'm a retiree. I'm not a radical. I can be
20 radical, but I'm speaking as a rational retiree today.
21 You never start a process without a written
22 plan, but we did. You want to know the consequences of
23 the action you're taking, but we don't.
24 Six months ago, the board passed this plan --
25 almost six months ago.

1 This week we went out to an RFP to the industry
2 to find out what insurance costs would be. That is not
3 the way you do business. That RFP is a three-week RFP.
4 When the county spends their money -- and I know, I was
5 there 32 years at the Sheriff's department watching those
6 pennies -- we did not spend their money with a three-week
7 RFP. They would have thrown us out of the office.
8 That process needs to be looked at and be
9 changed.
10 We need to encourage the decision-makers not
11 to become sharks, to live in a civilized society. We
12 don't eat our young, and hopefully we don't eat our
13 elderly retirees that are not represented in this
14 process.
15 We need to include retirees in this process.
16 You may not believe it, but they may actually have an
17 idea. Gaylan that just spoke has a number of ideas.
18 Number one, how do you calculate unfunded
19 liability? There needs to be a formula so that everyone
20 comes from the same point of view. Those retirees have
21 the time to develop retirement medical. We do not have
22 plans for retirees. We need to take that time and
23 develop those before we jump and put that -- and make
24 that decision.
25 Use Orange County as an example. Not as to how

1 they do this, but of how to learn from a way not to do
2 it. In other words, have a written plan, include the
3 retirees, honor your past commitments, work with the
4 insurance industry to develop the plans that you need.
5 You're here today in Orange County. This is
6 not the fantasy TV series that you see. This is a life
7 and death situation for many people. We need to take
8 that very seriously.
9 Another question that I would ask, after
10 32 years of working for the sheriff, is why can the fire
11 authority develop a system that takes care of their
12 retirees and they were once part of the county, and the
13 county now is abandoning its retirees?
14 Thank you very much.
15 CHAIR PARSKY: Keith Richman.
16 MR. RICHMAN: Thank you, Mr. Chairman and
17 Members. Good morning. My name is Keith Richman, and
18 I am president of the California Foundation for Fiscal
19 Responsibility, which is a coalition of taxpayer groups
20 and local leaders from around the state, dedicated to
21 addressing California's public pension and retiree
22 health-care cost crisis.
23 I'd like to thank Governor Schwarzenegger and
24 this commission for taking on this fiscal crisis. Left
25 unchecked, the spiraling cost of retiree benefits will

1 crowd out the needed investments in education, health
2 care, higher education, transportation, and public safety
3 our state and local governments must make to improve our
4 quality of life, and ensure that California remains
5 competitive in a global economy.
6 Indeed, we have already seen many of these
7 impacts now, both at the state and local level. They
8 have been well chronicled from around the state.
9 I'd like to focus, however, on what should be
10 the most important aspect of this commission's work:
11 Determining a fair retirement benefit for new career
12 employees, new career public employees.
13 And let me emphasize "for new employees."
14 As many of the previous speakers have said --
15 and I agree with them -- that the retirement benefits
16 for current employees and retirees were set by
17 negotiations between public agency officials and their
18 employee unions, and they cannot and should not be
19 changed.
20 These various generous benefits that exist now,
21 the highest in the nation, which you will hear from the
22 LAO, come at an unsustainable price. The first step in
23 resolving this fiscal crisis is placing a fiscally
24 responsible limit on the retirement benefits offered to
25 new public employees.

1 In fact, using an analytical instead of a
2 political approach to benefits design, the California
3 Foundation for Fiscal Responsibility started with a
4 widely recognized target replacement income level of
5 75 to 80 percent, and crafted a set of benefits to
6 deliver that income at appropriate retirement ages.
7 In our view, those retirement ages are 55 for
8 police officers and firefighters, 60 for other safety
9 employees, and Social Security retirement age for
10 everyone else.
11 Using the three-legged stool approach that
12 relies upon Social Security benefits where they are
13 available, a guaranteed defined benefit plan, and
14 employer programs for personal savings, the three-legged
15 stool that's historically been used, the California
16 Foundation for Fiscal Responsibility has found that a
17 fair retirement package can be offered using defined
18 benefit formulas similar to those currently used in
19 California.
20 Our economic modeling shows the State's
21 unfunded liabilities for retiree health care can be fully
22 paid with savings from fiscally responsible pension
23 benefits within 30 years.
24 The key factor is requiring public employees --
25 again, new public employees -- to work a full career to

1 receive full benefits, no longer allowing office workers,
2 road workers, mechanics, engineers, and the like, to
3 retire at age 55 with fully paid health-care benefits.
4 There is no reason these public employees performing
5 ordinary jobs should be allowed to retire at least
6 10 years ahead of their private-sector counterparts.
7 This commission must also consider measures to
8 stop the politicians' raids on public pension funds.
9 We've heard that from other speakers also.
10 The intentional underfunding of annual
11 contributions at all levels of government must be
12 stopped, as it relies upon illusory surpluses when stock
13 market returns are high that must be paid back when
14 investment returns hit the bottom of the cycle.
15 Governments should be making their payments
16 every year.
17 We owe it to employees and taxpayers, and let
18 me say retirees also, to keep these pension funds secure
19 and not divert them to other purposes, a fiscally
20 responsible principal that will become even more
21 important once retirees health-care funds are
22 established.
23 California Foundation for Fiscal Responsibility
24 will be filing a citizen's initiative in the weeks ahead
25 to act as a template for a new fiscally responsible

1 promise to all new public employees. We look forward to
2 an opportunity to discuss the details of our plan with
3 the Commission. We are hopeful that this commission and
4 the Legislature will adopt a similar retirement benefit
5 limit and trust-fund protections that would eliminate the
6 need for our initiative.
7 Yet as you will hear today from others, this
8 crisis is too important to depend upon the weak wills of
9 politicians who refuse to stand up to the special
10 interest groups and who have thus far sacrificed
11 California's fiscal health for their own comfort in
12 political futures.
13 California Foundation for Fiscal Responsibility
14 is hoping for the best from this commission and the
15 Legislature, but preparing for politics as usual from a
16 State Legislature that I'm well aware of.
17 Thank you very much.
18 CHAIR PARSKY: Thank you.
19 W. Darryl Adams, and then Cinda Combs, Mark
20 McCurdy, and our last speaker, Dave Elder.
21 W. Darryl Adams.
22 MR. ADAMS: Thank you.
23 Honorable Commissioners, my name is Darryl
24 Adams, and I'm an Orange County retiree.
25 Many of us who dedicated our entire careers to

1 the County do not have Medicare benefits to fall back on.
2 Some of us are still raising our children and in many
3 cases, providing caregiving for elderly parents. This is
4 often referred to as the "*sandwich generation*." And now
5 we will also be the "*donut hole generation*." We don't
6 qualify for Medicare and we're not indigent, which means
7 we don't qualify for Medi-Cal or SSI. We rely solely on
8 our earned benefit. We've worked hard all through our
9 lives, and now we'll have little or no medical benefit
10 when it is acknowledged that we'll need it the most.
11 Our benefits are being marginalized when we can
12 no longer do anything to compensate for it.
13 Since its inception, the county retirees'
14 medical benefits have been in the same pool as active
15 employees. To make the withdrawal and subsequent
16 increase in costs to retirees retroactive without even
17 the participation of those affected is unconscionable.
18 In our personal lives, if we found ourselves in
19 financial trouble because we made poor choices, wouldn't
20 it be nice if we could go back to our mortgage company
21 and renegotiate the purchase price of our home?
22 We, the retirees, are being abandoned for the
23 wrong reasons, for something we did not create. The
24 county is suffering, not through the acts of dedicated
25 employees, but through the acts of politicians and

1 appointed officials. Yet I haven't seen any of them
2 elect to take a cut in pay or benefits.
3 I believe that any reduction to retirees'
4 benefits should be directly tied to a commensurate
5 reduction in the salary and benefits of all elected
6 employment officials.
7 They could be given Toyota Corollas to drive
8 instead of Lincoln Towns Cars and their per diem could be
9 coupons for McDonald's Happy Meals. Perhaps we can put
10 that on the same ballot that Mr. Moorlach proposes for
11 the employees' benefits packages and let the constituents
12 decide their fate as well.
13 Thank you.
14 CHAIR PARSKY: Cinda Combs.
15 MS. COMBS: Good morning. And thank you for
16 this opportunity.
17 I thought I would just share a few numbers with
18 you. I don't have the big picture. I'm just going to
19 give you my picture.
20 I'm a retired Orange County employee, 70 years
21 old. I went to work for the county after my husband's
22 death. I am receiving -- or will receive very soon, they
23 say -- 1,890 per month. And I will be required to
24 forfeit virtually all of the Social Security that I
25 have been receiving because of the government pension

1 offset. I went to the Social Security office Monday,
2 and they're computing that.
3 I currently pay $1,300 rent on a 500
4 square-foot one-bedroom apartment.
5 Oh, by the way, I meant to tell you that these
6 numbers -- I'm moving to Arizona next month. I want to
7 think of it as an adventure, but these numbers are why.
8 Okay, so you subtract the $1,300 from the
9 $1,890, you get $590. My medical insurance currently is
10 the WellWise Plan. That's a $300 deductible.
11 The cost to me is partially offset currently by
12 a grant, but I understand that that is probably going to
13 be severely cut next year.
14 But my insurance -- health insurance at the
15 present, $320 for WellWise, $46 for dental, $8 for eye
16 coverage, Medicare, $93. That totals $467.
17 Now, when I deduct the $467 from the $590, that
18 leaves me $123 per month to cover the $300 deductible
19 co-pay -- or excuse me, the $300 deductible on the health
20 insurance, should I need it.
21 The co-pay, any other insurance -- automobile,
22 car expense, gas, utilities, food, it doesn't seem
23 workable. So at any rate, I'm fortunate because
24 I do have, through my husband's Social Security, I have
25 entitlement to Medicare.

1 The people that don't have entitlement to
2 Medicare, their insurance would go up to $717 a month,
3 which you can't really subtract from $590.
4 Anyway, that's it.
5 Thank you very much.
6 CHAIR PARSKY: Thank you.
7 Mark McCurdy and then Dave Elder.
8 MR. McCURDY: Mr. Chairman and panel, thank you
9 for allowing me to speak here today.
10 I'm a resident of Fountain Valley, a resident
11 and concerned citizen. And I've made it my priority to
12 be involved in the safety and quality of life in my
13 community.
14 Currently, I serve on two city committees and
15 have just finished my year as the Chamber of Commerce
16 president in my city.
17 I have had the opportunity to see firsthand how
18 rising costs -- primarily escalating health insurance
19 costs and extensive retirement benefits -- challenges the
20 quality of life in our community.
21 Recently, our city has had to lay off five
22 employees, including our city receptionist -- we don't
23 have one anymore -- to help pay for these costs. We are
24 now starting to contemplate our city's long-term future
25 if things continue, including the loss of our police

1 department, and possibly consider someday having the
2 sheriff do our policing.
3 It's time that we get real about excessive
4 retirement benefits that are not in line with the private
5 sector before our communities lose vital services and
6 quality of life. What good is it if you gain your
7 benefits if you don't live in a community without
8 services and quality of life?
9 We should be grateful that we've enjoyed the
10 healthy and robust real estate market the last few years.
11 The revenue generated has helped offset these costs. The
12 cycle has now reversed, and we can't expect the same kind
13 of revenue from our real estate. And I think we need to
14 get real before it's too late, and we need to take what
15 steps and actions we can to preserve the quality of life
16 in our county and in our state.
17 Thank you.
18 CHAIR PARSKY: Thank you.
19 Our last speaker is Dave Elder.
20 MR. PRINGLE: Let's applaud that, the last
21 speaker.
22 MR. ELDER: See, it's all downhill from here.
23 I have something I want to pass out to
24 everybody. I don't expect you to read it now.
25 This article talks about the unfunded

1 health-care liability of public employees. And at the
2 time this was written, I was the chairman of the
3 Retirement Committee in the Assembly, a post I held for
4 ten years.
5 I describe the unfunded health-care liability
6 as a large -- as "Jaws II." And it was $100 billion when
7 I wrote this or when I was interviewed.
8 What's interesting about this article is, it
9 was written on September 13, 1987. And so here we are,
10 20 years later looking at this problem. And it turns out
11 that $100 billion is probably about the right number:
12 The state is $40 billion, and public agencies probably
13 make up at least one and a half times that.
14 This problem caused me to establish in
15 legislation the Post-Retirement Health-Care Fund, which
16 was implemented in statute about 1989. I took a check
17 over to PERS for $100 to start the fund. They tore up
18 the check and did not start it. And by now, there would
19 have been about 300 bucks in there just on what I put in.
20 It wouldn't help that lady going to Arizona very much.
21 Anyway, I give this to you. This is not a new
22 problem. The fund was created, I think, three months ago
23 and first started putting money into the fund that I
24 created in legislation in 1989.
25 We talk about our teachers, when I was chair,

1 40 percent of the teachers in the state did not have
2 health insurance and retirement. In '86, the Tax Reform
3 Act required them to start paying Medicare premiums on
4 taxes. And so a lot of those are going to be covered.
5 But, anyway, 526 requires the school
6 districts -- and that statute, too -- to provide health
7 insurance to the retirees, but they have to pay the full
8 cost. And the full cost not of the entire group, but of
9 the retiree group. So these premiums are astronomical.
10 There probably needs to be addressed, making it
11 some percentage, 125 percent. Some of these school
12 districts, as you may know, 500 school districts in the
13 state of California have less than a thousand students
14 out of a thousand districts. And so when you have
15 retirees from that very small district, the average costs
16 can be astronomical because of the fact of these things.
17 This 526 approach needs to be -- maybe you want
18 to look at that legislation and apply it to all public
19 agencies in the state, require them to sell it -- at
20 least sell it to the retirees. Not that all of them can
21 afford it.
22 I guess in a more cynical approach to the
23 health-care unfunded liability is simply don't allow
24 anybody to retire. Just keep working. Keel over at your
25 desk, and you never have retiree health-care costs.

1 But we have to think in terms of -- and this is
2 kind of a gross thing, and it's meant for humor, probably
3 for Dr. Richman's benefit -- if you think about it, about
4 the cost of health care, Cadillacs used to be $5,000 a
5 year -- or for five thousand bucks, you could buy a new
6 one. They're about $50,000 now. Chart that out and see
7 where that takes you.
8 There are two bills that I passed in the late
9 eighties, AB 373 and I think it was AB 1492 -- and I am
10 speaking from memory, and that's going rapidly -- that
11 set up a catastrophic health insurance plan for
12 Californians. This was stolen directly from The Wall
13 Street Journal, a very radical publication. It called
14 for a $50,000 deductible, million-dollar coverage. Your
15 other insurance covered you up to whatever the amount
16 was. Whatever was paid by the other insurance and by
17 yourself counted toward that 50,000. But if you had a
18 young son or daughter trying to take out a tree with
19 their car and they were in a coma, these costs can get
20 extraordinary. And this million dollars coverage was for
21 that type of occurrence.
22 The premium at that time was $68 a year. Those
23 bills -- those statutes are on the books, and have never
24 been implemented. So I might direct you a little
25 attention there.

1 I'll have much more to say about these other
2 issues that are really not related to health care. But
3 I have spent a little toiling in this field. I did set
4 up the fund.
5 I've been criticized by PERS for not providing
6 enough details in the legislation. Hell, I couldn't
7 explain to people what I was talking about 20 years ago,
8 let alone get any help in drafting the legislation. So
9 it probably needs some tinkering. But now we've got
10 people that are focused on it, like yourselves. And I
11 appreciate, and the people of California ought to thank
12 you profusely for taking on this issue.
13 Thank you very much for your time.
14 I think you'll find this kind of interesting.
15 But I just want to let you know that this is not
16 something that just happened.
17 CHAIR PARSKY: Thank you. Thank you very much.
18 And I want to thank all members of the public.
19 I really want to thank all members of the
20 public for commenting. We've really allowed the public
21 comment period to be extended, in part because the
22 purpose -- one of the basic purposes of this session, and
23 the sessions we're going to hold throughout the state, is
24 to hear from the public, let the public hear exactly what
25 kind of analyses have been presented to us, and provided

1 input on this important issue.
2 The only general comment I would like to make,
3 and perhaps I should have introduced this session today
4 by saying something we did at the beginning of our first
5 session, and that was that the Governor and the
6 legislative leaders, as they established this commission,
7 made it very clear that, from their perspective, promised
8 pensions and health-care benefits to existing employees
9 would be met.
10 There is no attempt on the part of this
11 commission to retroactively attempt to deal in any other
12 way, because that was one of the bases upon which the
13 Commission was established.
14 And once again, the Commission is tasked with
15 three basic responsibilities:
16 One is to try to identify the amount, the full
17 amount of the post-employment health-care and dental
18 benefits for which the governments are liable, and which
19 the governments have to establish a way to honor.
20 Second, to evaluate and compare various
21 approaches addressing their unfunded pension and
22 health-care obligations, whatever they may be. And we
23 can have a debate as to whether there are unfunded
24 obligations or not. But once again, they need to be met
25 and honored.

1 And finally, to propose a plan to see how the
2 government should finance these obligations in a fiscally
3 responsible way.
4 So, again, in each part of the state that we
5 go, we want to emphasize again what has been established
6 as a given for this commission. And I certainly
7 appreciate concerns that have been expressed by retirees
8 or current employees with respect to promises that have
9 been made.
10 But at least the leadership that established
11 this commission has made it very clear that they claim to
12 honor those obligations.
13 A few administrative things. There is an
14 evaluation form in everyone's packet, and I would
15 appreciate it if everyone would, at some point during
16 today, fill it out, to see how we can improve these
17 sessions. It's meant for that. We've set up a Web site,
18 which I think everyone is familiar with, so that the
19 public can keep up to date on everything that is going
20 on. And working with various associations of the
21 government entities, the Commission has begun to survey
22 local governments during this past week to collect
23 information and data.
24 Before we turn to our first panel, we also have
25 the California Research Bureau has prepared a background

1 briefing that are in these packets. And I just would
2 like Grant Boyken to spend a few minutes just making sure
3 everyone understands what that report is.
4 MR. BOYKEN: Thank you, Mr. Chairman, Members
5 of the Commission.
6 I just want to give you a very brief outline of
7 the contents of the report.
8 The purpose of the report was really to provide
9 sort of a broad background of many of the issues that
10 you'll be considering in the coming months, and it's
11 divided into two sections.
12 The first section is an overview of public
13 employees in California, including the size of the public
14 employee workforce, how public employees are distributed
15 among different government employers, retirement system
16 membership, and a broad summary of post-employment
17 benefits, and how those benefits are funded.
18 The second section of the report addresses many
19 of the issues that the speakers here this morning already
20 addressed, key issues that have shaped recent
21 discussions, issues such as new accounting and reporting
22 standards for health and other post-employment benefits,
23 coupled with the rising costs of health care, the rise
24 and fall of public pensions funds, their system funding
25 ratios in the late nineties, and then the fall in the

1 early part of the two thousands, demographic shifts that
2 are predicted to change the nature of retirement to
3 increase the retirement roles and also increase average
4 lengths of retirement time.
5 And also it addresses recent issues about
6 questions about whether or not government employers
7 should follow the private-sector lead in going into
8 defined contribution plans.
9 And the report really concludes with some
10 observations of what appear to be the most -- some of
11 the most pressing, underlying questions in all of these
12 debates, questions about the comprehensiveness of public
13 employee post-employment benefits, questions about the
14 costs, how those costs can be managed and distributed.
15 And also issues of control, control over how benefits
16 should be designed and administered.
17 And before I conclude, I just want to point out
18 a typo. We got this back from the printer, and it's
19 always a bad omen, the very first figure has a typo in
20 it. If you turn to page 2, figure 1, there's a part on
21 the pie chart, that the pie slice that's labeled
22 "CalPERS, 6 percent." That should read, "Cal-PERS
23 classified school numbers," and the number there should
24 be 19 percent.
25 UNIDENTIFIED LADY: What percent?

1 MR. BOYKEN: 19 percent.
2 CHAIR PARSKY: Thank you. Thank you very much.
3 Okay, we're going to now move to the first
4 presentation, it's a panel. The subject matter is:
5 Addressing Unfunded Liability: The Orange County
6 Experience. And we have six members of this panel.
7 We're going to try to complete this discussion before
8 lunch.
9 So would all members of the panel please come
10 forward. And hopefully we can fit everyone in. If we
11 can't, then we'll bring some extra chairs.
12 And I think what we'll try to do here for our
13 Commission Members is let all members of the panel make
14 their comments and then we'll open it up to questions and
15 we'll try to complete this discussion by 12:30.
16 Has the panel decided which order? Or do we
17 pick the order?
18 MS. SHEEHAN: No, it's on the schedule.
19 CHAIR PARSKY: The order is here? Okay.
20 John Moorlach, you'll begin.
21 MR. MOORLACH: Thank you, Chairman Parsky. I'm
22 trying to get the screen up.
23 Thank you very much. It is a real honor to
24 have been invited to speak to this commission,
25 Mr. Chairman and fellow Commissioners. I am very

1 impressed with the roster you have today. We need to be
2 dealing with this -- what might be addressed as a
3 two-headed monster -- addressing pension plans and
4 retiree medical. I could talk on this for eight hours,
5 and I can certainly see that the other speakers today
6 could certainly give a lot of thoughts. But I just want
7 to give some --
8 CHAIR PARSKY: A little shorter than eight
9 hours.
10 MR. MOORLACH: Yes. I'll keep it to seven
11 and-a-half. Thank you very much.
12 I just want to start with some recent
13 headlines.
14 Just last week, Contra Costa, in the
15 Contra Costa Times, noted that their unfunded retiree
16 health-care bill is now up to $2.6 billion. This is just
17 one county.
18 To make a payment of that, we had a bankruptcy
19 debt in Orange County where I serve as supervisor and
20 formerly as treasurer, we had a billion-dollar bankruptcy
21 debt, and it cost us approximately $90 million a year to
22 pay on that debt. So they probably have somewhere around
23 9 percent, or $234 million to set aside just to meet that
24 debt.
25 Okay, actually, they've determined that the

1 shortfall that they have to pay every year is
2 $227 million. But they're only earmarking $33 million
3 a year. That means they're $194 million short. And
4 they'll have what we would call an unfunded liability
5 that they'll have to report on their GASB 45 because
6 their ARC, their annual required contribution, should be
7 $227 million.
8 Los Angeles County last week, in their budget,
9 came out and said their retiree health-care deficit is
10 now as high as $14 billion, which just went up some
11 $5 billion. That was in the Daily News of last week.
12 And you can figure if they want to start making their
13 ARC, that's about $1.26 billion a year. But they're only
14 setting aside currently about $200 million. It's going
15 to go up to $400 million in the next fiscal year, and
16 you're looking at $500 million in 2010 or 2011, which
17 still puts them short about $860 million a year.
18 What was very interesting is their chief
19 administrative officer, Mr. Janssen, said that revenues
20 were up for the third consecutive year. This is true for
21 Orange County. Our assessed values have gone up
22 10 percent per year over the last three years. Very
23 unprecedented, but as has been the trend with the real
24 estate market, which was referred to earlier by a prior
25 speaker. But that is slowing down. We saw just

1 yesterday in the LA Times that the market had dropped in
2 new home building, to the lowest number in 18 years.
3 We're starting to see it, and it's starting to impact the
4 counties as we move forward.
5 In fact, just last week, The Sacramento Bee
6 reported that their county assessor has issued 50,000
7 letters to homeowners, saying that their property values
8 will be reassessed down to reflect what's happening in
9 the marketplace in that county, which means that their
10 revenues will decline perhaps 10 percent, or a reduction
11 of $15 million per year.
12 This fiscal year, Orange County was lucky to
13 have a good real estate return, but about 81 percent of
14 those revenues went into our pension plan. This is also
15 true for New York City. Mayor Bloomberg since 2002 has
16 seen 75 percent of his new property tax revenues just go
17 into the pension plan.
18 So we've been very fortunate for the recent
19 uptick in the real estate market.
20 Regretfully, Sacramento County, their revenue
21 increases have not been enough to cover their POB, their
22 pension-obligation bond, payments percentile and their
23 pension-plan obligation. They're actually falling
24 behind. So this is very bad news for the County of
25 Sacramento.

1 So that just kind of gives you a little
2 groundwork of what we're facing. We have a fiscal issue.
3 And as elected officials, as union representatives, we
4 have to look at the scenario and make the best decisions
5 we can, going forward.
6 I don't want to spend a lot of time on
7 explaining to you what the defined pension plan is. I
8 just found this prescient quote from Peter Drucker which
9 he made in 1950. Peter was here at the Claremont, just a
10 wonderful academic speaker and writer, a management
11 consultant of world renown. But he just kind of gives
12 some perspective. He said the only business that should
13 really be offering a defined benefit pension plan is one
14 that's going to be here for 40 years. Who can actually
15 predict whether a company will be around for that length
16 of time to honor all those commitments?
17 And that is true. Well, we're finding that
18 there is one industry, and that is government is always
19 here. And so now we can have a defined benefit pension
20 plan.
21 So I want to say two things: One, I am not
22 anti-defined benefit. I'm not anti-employee. I just
23 want to give you some ideas because I want to provide
24 some balance. We're here. I think some things are
25 broken that need to be looked at. And I think there's

1 lots of blame to go around where we might be able to say,
2 okay, that's what we did before. Let's try it a little
3 differently moving forward.
4 So I'm just going to give a Letterman "Top 10"
5 kind of ideas, and then if I have time, I'll go into our
6 retiree medical changes here at the county.
7 But currently, issue one is that we have very
8 non-transparent contract negotiations, and we're finding
9 that we have some interesting things that come up with no
10 public input, no opportunity for people to speak. You've
11 had some brave souls today that were able to come and
12 able to speak. But I think we need to focus on open and
13 public negotiations, we need to discontinue closed-door
14 discussions with minimal public notice of a proposed
15 contract, before an open vote.
16 Last fall, San Jose did everything in closed
17 session, released the information in the morning, and
18 that afternoon their City Council met again and voted on
19 the contract. We might even consider retaining
20 independent third parties to negotiate employee
21 bargaining unit agreements.
22 Issue two is approving retroactive benefits.
23 This is an immediate unfunded liability. The argument
24 has been, "Well, we need to offer this benefit so we can
25 recruit." But this is not retroactive -- recruitment is

1 not a retroactive issue, it's a prospective issue. So
2 we have made some major gifts of public funds immediately
3 overnight which create these large unfunded liabilities.
4 It's a debt that now has to be paid by the taxpayers of
5 the municipality involved.
6 So I would certainly provide as a remedy that
7 we need to treat proposed enhanced benefits as a debt
8 subject to the same limitations that are on our books
9 with Prop. 13 and Prop. 218 requiring a vote of the
10 municipality's constituents.
11 Or you also want to think about requiring that
12 when a municipality creates a new benefit enhancement,
13 that it should be paid the day it becomes effective.
14 This is what the state of Georgia does, and their
15 unfunded liability is about zero. They're 100 percent
16 funded. If you want a benefit, you pay for it
17 immediately. That's a model to look at.
18 And requiring increased employee contributions
19 to cover the costs of enhanced and retroactive benefits,
20 this is being done in Orange County, and I find out this
21 morning also, it's being done in Sonoma County.
22 Just one example would be the City and County
23 of San Francisco, which is a charter county. It's had
24 the requirement that any pension enhancement be voted on
25 by taxpayers, on their books for quite some time. And

1 they are currently 104 percent funded, at least as of
2 September of 2005. The numbers have changed a little
3 bit.
4 We are showing as being 69 percent funded. I
5 believe we're now up to 71 percent, with the most recent
6 numbers from our actuary.
7 But it sort of shows you that the dot-com bust
8 is not necessarily the only argument in the room, because
9 San Francisco went through it and today is 100 percent
10 funded as compared to some other entities in the state,
11 which means that we have to look at what was the impact
12 of these increased benefits when things were really
13 flying high.
14 Number three is increasing life expectancy and
15 decreasing retirement ages. When you have a funding
16 period that has been shortened, that creates higher
17 payments up-front. And now when you have life
18 expectancies going up further, you receive a longer
19 pay-out period. So these actuarial numbers are getting
20 to be rather astounding. And even today's LA Times
21 business section already talks about the possibility of
22 ever extending lifetimes with new technology coming up.
23 So we are creating some remarkable problems going
24 forward. Again, you can't use the word "crisis," but
25 you still want to say, "Well, what happens if this all

1 plays out?" We've got to be responsible about it.
2 So one of the things we need to look at is
3 perhaps going back to increasing retirement ages.
4 Currently in Orange County it's 55; we should look at
5 62 for general members. And 50 for public safety, we
6 should consider 57, in that range for public safety
7 members. We have seen a workforce exodus, we are seeing
8 public safety officials at 50 say four words: Why work
9 for free? And they are retiring when they can get
10 80 percent of their salary, why not, and they can
11 certainly go somewhere else and be a chief or captain or
12 something else, or go into a different industry.
13 We may need to consider cost-of-living
14 adjustments if the plan is not fully funded. That's
15 another thing that needs to be fully reviewed.
16 With this issue, we've seen just a dramatic
17 exodus of good managers leaving the county. I lost –
18 my department last year -- my top six people, because of
19 their ages, they said it's time to go. And they all kind
20 of left in the month of March because April is when the
21 cost-of-living increase kicks in, and so I'll kind of see
22 these spikes in the month of March.
23 Number four, salary spiking. We're the only
24 state that allows for computing your retirement
25 remuneration based on your last year of service. We're

1 the only state out of 50 that does that. Other states
2 are three years.
3 Number five, actuarial assumptions and
4 amortization abuses. We've certainly seen a lot of
5 interesting issues here of how to select an interest
6 rate assumption, how to amortize gains and losses from
7 investments, how to amortize gains and losses from plan
8 changes, how to amortize gains and losses from experience
9 changes. We've certainly seen a radical change in Orange
10 County when all of a sudden your actuaries assume you
11 would be retiring at 65'ish, and now they're retiring at
12 55'ish. All of a sudden, the numbers really spike, and
13 that's what we saw here in this county.
14 So I would certainly think that this commission
15 should look at standardizing, so we can at least have a
16 fair playing field as we compare unfunded liability
17 between county-and-county and city-and-city, because
18 we're all using a lot of different factors. The matrix
19 does get rather complex.
20 One quote, since we're quoting The Wall Street
21 Journal quite a bit, there was an editorial by
22 Mr. McMahon, "Public Pension Price Tag," in The Wall
23 Street Journal this last August, and it actually referred
24 to using a lower, a required rate of return and invest
25 accordingly, so we can reduce the taxpayers' collective

1 risk.
2 Issue number six is asset-allocation abuses.
3 I don't want to shock you, but money managers are part of
4 the problem as well. Certainly they are getting
5 compensated, and you want to follow the money. So I'm
6 just kind of using this as a catch-all for how funds are
7 managed. But certainly when a money manager sees that
8 price earnings ratios are well above the mean, they
9 should be telling you to liquidate their money so you
10 could capture those profits, perhaps. Certainly that
11 should have been done before the dot-com bust. But they
12 were all saying, "No. Stay. Stay and hold onto our
13 small caps, because we need to be paid. We don't get
14 paid if you're not investing monies." So lots of things
15 could have been avoided back in the early part of this
16 decade.
17 So we need incentivized money managers to do
18 the right thing, not just hang on, hold tight, and then
19 live with the results.
20 Pay to play is still available. Not in a
21 municipal debt market. I'm not allowed to pursue bond
22 underwriters or individuals in industry for campaign
23 contributions, yet you can go to any money manager at
24 CalPERS or any institution here in this state and you
25 can still go after them for contributions for your

1 campaigns. This was reported on by the LA Times by Evan
2 Halper, I had the chance to meet him. He's usually out
3 of Sacramento, but he is in the audience today. But he
4 reported on Steve Wesley and Phil Angelides doing this.
5 I can give you a lot of horror stories if you
6 were to give me a little more time on what happens when
7 this financial opportunity gets into the mix. So I would
8 encourage you just -- that's a simple solution in one
9 area that's to prohibit pay to play.
10 Disability retirement abuses is another
11 eight-hour discussion. But we've certainly got to
12 develop stronger penalties for fraud and what we now call
13 "chief's disease." 80 percent of California Highway
14 Patrol chiefs that retire have filed for disability.
15 Now, that's not an immediate cost to the plan, but it
16 does cost the taxpayers because disability benefits are
17 50 percent tax-free. So we all carry that burden.
18 We also have a lot of presumptive code
19 provisions that allow for certainly industry segments to
20 retire based on just a presumptive whether they had a
21 family history of heart disease has nothing to do with
22 it. It's just that you're in this profession, and then
23 you can retire. So some of those things need to be
24 looked at.
25 Number nine -- I'm just about done with my

1 Top 10 -- employer contribution holidays, which I was
2 just glad to hear a lot of your speakers mention today.
3 New Jersey, which Gerry -- Mr. Parsky, you joked about
4 a little bit, but the state of New Jersey is a poster
5 child of pension plan problems. But they had a six-year
6 holiday. They didn't make -- the government didn't make
7 one payment for six years into the pension plan. This
8 is just outrageous. We had Mr. Griffith who mentioned
9 that we were paying only 1 percent into our pension plan,
10 which, even as a board member of the retirement system, I
11 was saying, "God, we've got to get this up. You can't
12 just be enjoying this big reduction," but the county did,
13 and they spent the money elsewhere. And they didn't set
14 funds aside for when the cycle would change, as we know
15 these cycles do occur.
16 So we should certainly look at requiring some
17 kind of escrow accounts during good times to smooth out
18 the tougher years. We need to revert to the mean as well
19 in managing our money. And I think union leaders are
20 right when they point to the county and say, "What did
21 you do with our money?" That needs to be looked at.
22 We need to discourage unrealistic deferral and
23 smoothing methods and we need to start having an
24 aggressive strategy in the good years to deal with the
25 down cycles.

1 Number ten is we have sluggish taxpayer wages
2 to support growing pension costs. Just last week, we
3 got an announcement from the private sector that most
4 individuals in the private sector are expecting raises
5 of only about 3 percent this coming year. But they're
6 watching public employees earning almost 50 percent more
7 on average than themselves in jobs of similar
8 descriptions. So the taxpayers are starting to figure
9 out what the problem here is, and they would like to see
10 some remedies.
11 I know we've heard two-tier plans discussed
12 quite a bit from the podium. But it certainly has to
13 be reviewed for future hires. We also have to consider
14 defined contribution plans or hybrids in order to share
15 the risk burden.
16 Just last year, a study came out that showed
17 that California state workers under age 50 who worked for
18 a period of 10 to 15 or 20 years would actually receive
19 a higher retirement income if they switched from a DB to
20 a DC plan.
21 In the public sector, we have about three major
22 solutions that are being pursued. One was mentioned
23 earlier, and that was to do a pension obligation bond, a
24 POB, which is substituting one debt for another.
25 We can also, obviously, increase our yields on

1 our pension funds. Ha, ha. I mean, if you can find me
2 the way to do that, then just spread it around and give
3 us all a tip.
4 Or we need to increase employer contributions
5 into the pension plan, and then, therefore, you're
6 hearing that the request for tax increases. But there is
7 a limit to that as well.
8 We have not seen what Chapter 9 bankruptcy can
9 do to pension plans. It's unproven. Although San Diego
10 came awfully close in the city when one of their mayoral
11 candidates said that that's what he would do, the next
12 day after he got elected, he would file for Chapter 9 and
13 let a federal judge try to sort it out.
14 And we haven't seen freezes or terminations
15 which are being done in the retiree medical arena.
16 I could talk for a little while, too, on the
17 retiree medical at Orange County, so I want to be
18 respectful of my time. But I guess I'll jump to my
19 conclusion and then if we have time I can come back to
20 this. But we need to provide fair post-employment
21 benefits to our workforce, we need to protect the
22 financial integrity of the employer, we need to honor
23 the obligations we've already created, and we need to
24 start reducing unfunded liabilities now so that our
25 legacy costs are not saddled on our children and on

1 our grandchildren. And we need to avoid taxpayer
2 disconnect, as they are already in polling data
3 showing they definitely want some type of reforms.
4 Thank you, Mr. Chairman, for letting me talk
5 this quickly.
6 CHAIR PARSKY: I appreciate it. You've
7 provided
8 a lot of information. We'll get through the panel and
9 then come back, and there maybe some questions, and
10 we'll move in that direction.
11 Joe Kerr?
12 MR. KERR: Thank you, Mr. Chair. I appreciate
13 it very much, and thank you, Honorable Board.
14 I’m Joe Kerr, President of the Orange County
15 Professional Firefighters.
16 The Orange County Fire Authority protects
17 22 cities in Orange County, 1.3 million citizens, a
18 quarter of a million acres of wildland and 500 square
19 miles.
20 The Orange County firefighters are a
21 multifunction dual role, and they've been in such places
22 as 9-1-1 and made 200 rescues in Katrina.
23 In order to understand the position of Orange
24 County Firefighters with regards to public employee
25 benefits and associated protections, you need to kind

1 of understand the genesis of our organization.
2 Orange County Firefighters were formed in the
3 throes and chaos of the Orange County bankruptcy of 1995.
4 At that time we had our contract voided. We had our
5 contract abrogated. All of our raises, all of our COLAs
6 were gone. Ten percent of our deferred comp was stolen.
7 We had to ask President Clinton to intervene and get some
8 of that back and help out.
9 We were looking at layoffs of 100 firefighters,
10 200 firefighter paramedics, and there was even an attempt
11 to dissolve the entire Orange County Fire Department at
12 that time to save $100 million.
13 One of the benefits of surviving a municipal
14 bankruptcy is the knowledge that in order to secure our
15 employees' future, we must work to secure our employer's
16 future. And to that end, over the last decade, we have
17 worked to bring in over $100 million in government grants
18 and functional revenue to our employer.
19 However, last year we were faced with the
20 potential loss of a benefit that we thought was secure.
21 Our employer informed us that the retiree health-care
22 trust, which was funded in good faith for 13 years, was
23 going to run out of money in about eight months. There
24 was 234 current retirees.
25 As a new organization, we do not currently have

1 a lot of retirees. We only have a little over a thousand
2 personnel in the entire department.
3 Coincidentally, at the same time, GASB 43 and
4 45 came into play. And the results of what we were
5 looking at is actuarial studies showed us that if no
6 changes were made to our funding structure, our unfunded
7 liability at the time was going to be $66 million. If
8 the retiree medical trust could be transferred and
9 invested with a third-party trustee and earned at an
10 interest rate such as Orange County employee retirement
11 system, it would be looking at a reduced rate to
12 $27 million. If the retiree medical trust were invested
13 at a higher yield and contributions were increased, the
14 unfunded liability could be eliminated entirely, is what
15 we were told.
16 We also recognize the fact that the concept of
17 unfunded liability is not a disaster. It merely
18 identifies the true ongoing costs of the benefit.
19 Within the context of our politically
20 conservative county and our 24 board of directors, from
21 22 of our cities, and after extensive negotiations
22 between the fire authority and the professional
23 firefighters, we came up with the following plan.
24 This plan happened to work for uses in that
25 specific time of need. I don't propose that it would

1 work for any other group any other time.
2 We pursued enabling legislation. The Governor
3 signed AB 2863, Karnette, which allowed us to invest our
4 retirement health-care medical trust fund money into
5 OCERS, doubling the rate and the return. We increased
6 our investment return by doing that.
7 We also asked for and received employee
8 contributions. We raised our contributions from
9 1 percent from the employee to 4 percent. We did this
10 by basically using a pending COLA, and our members
11 ratified that by 90 percent.
12 We also increased one-time cash contributions
13 from the Firefighters Association Health-Care Trust of
14 a million dollars, and from the Fire Authority, they put
15 in $7 million. It was a one-time cash infusion of
16 $8 million.
17 We established a new benefit plan for future
18 employees. It's not something you want to do as a labor
19 leader, but it's one of the few options we had left.
20 We established a benefit plan for employees hired on or
21 after January 1st, 2007. This new plan is a retiree
22 health savings plan, and the employees contribute the
23 same amount of 4 percent of their base salary.
24 Contributions are deposited in individual
25 accounts, managed by the employee for the future retiree

1 medical expenses. We believe that this new program is
2 going to offer the same retiree health-care coverage as
3 what their brothers and sisters received in the previous
4 DB plan.
5 The agreement was based on several actuarial
6 analyses that showed contribution rate of 4 percent of
7 salary, earning an assumed rate of 7.75 percent would
8 fully fund the benefit for our active employees for over
9 the next 30 years. Several other factors contributed
10 to this agreement. We were committed to solving this
11 issue without separating our retirees from active
12 employees for the purchase of their health insurance.
13 We offered health-care benefits to both the
14 retirees and our active employees. If we were to
15 separate our retirees from this pool, the increased
16 utilization rate was going to make health care
17 unaffordable. And, again, we recognize this solution
18 does not work for all agencies. The Fire Authority had
19 only 234 retirees affected by this issue. This made the
20 dollar amount necessary to fix the problem for us
21 achievable.
22 One of the components of the issue is the
23 one-time cash contribution. We were able to free up
24 money to get that one-time cash contribution by savings
25 that we realized previously.

1 We saved some money on workers' comp costs and
2 utilization of employee health care by implementing a
3 wellness/fitness program. The median age of our
4 firefighters is 46. The median age of our entry
5 firefighters is 34. Half of our force is eligible to
6 retire in six years.
7 In addition to that, we lost 1 percent of our
8 workforce due to line of duty deaths in an eight- or
9 nine-year period. Eight firefighters in the thirties and
10 forties died from detectable and preventable illnesses
11 and injuries.
12 One of our 44-year-old fire captains died in a
13 firestorm in Riverside three weeks after he buried his
14 firefighter. So we had to do something. And what we did
15 is we created a labor management cooperation to implement
16 a wellness/fitness program.
17 Since the inception of the wellness/fitness
18 program, which includes annual tests, the Fire Authority
19 has only lost one firefighter to occupational illness and
20 has stabilized workers comp costs to previous levels. In
21 2002 they went up 300 percent. We've gone back down to
22 previous levels.
23 The utilization rate of health insurance for
24 our firefighters has also been reduced significantly.
25 The reduction has produced a considerable savings in the

1 cost of employee medical insurance. And due to those
2 savings, realize that the implementation of the WEFIT
3 Program, both the firefighters and the Fire Authority
4 were able to put that one-time cash infusion into the
5 negotiated solution to this issue. It worked for us.
6 In closing, I'd just like to offer some basic
7 tenets that we'd like -- what we followed, that are
8 precepts that we think are important on behalf of the
9 Orange County firefighters. We recognize that one size
10 does not fit all. What works for us may not work for
11 anybody else. We also recognize and respect that locally
12 negotiated contracts should be respected.
13 We would have preferred to have kept the DB
14 retiree health-care plan, but it was not an option for
15 us. We don't propose that any other entity should
16 emulate what we've done. It was our solution to a local
17 problem, not something that can necessarily be copied.
18 Circumstances forced the firefighters into these
19 negotiations. No labor organization wants to create a
20 second class or second tier of employees, even though we
21 inherited a two-tier retirement system from our
22 predecessors.
23 The current issue is extremely complex. It
24 requires the full cooperation of labor and management and
25 policy makers to achieve a solution that fits the current

1 conditions and will stand the test of time, as far as
2 we're concerned.
3 The Orange County Professional Firefighters are
4 not proponents of establishing multiple tiers. And
5 that's something we really need to make sure that
6 everybody's aware of. Because we think that in the
7 future, when the Baby Boomers are pushed out by the
8 Gen X'ers, it may manifest itself into disgruntled and
9 angry employees demanding that they also be made whole.
10 The solution to the retiree medical trust issue
11 helped to, we believe, ensure the long-term viability of
12 our defined benefit pension program because there was
13 some freeing up of some money that helped substantially.
14 Our solution to this issue was based on a
15 fusion that married the savings from our workers' comp,
16 the savings of reduced health-care utilization, the
17 advantages of a fully funded retiree health-care system,
18 and the support of local government structure that was
19 open to the mutual benefits derived of these programs.
20 We had support from the Legislature and the Governor in
21 the signing of that bill that allowed us to double our
22 investment return, and we appreciate that very much.
23 The result in savings that we realized by the
24 implementation of the WEFIT program is what made this
25 program possible. Without it, having been in the right

1 place at the right time, we may not have had these
2 options available to us.
3 And lastly, we believe that retirement benefits
4 are significant enhancement to the state's economy, and
5 that they provide a tremendous boon to our local
6 economies.
7 I gave you basically a little bit more detail.
8 All the attachments you should have in front of you, and
9 the CD. And if you don't have it, I'll get those to you.
10 We've also attached a statement of facts from
11 the California Professional Firefighters or state counsel
12 on these issues. And I've got a couple folks here that
13 are a lot more intelligent on this issue than me. If you
14 have any specific detail or technical questions, I will
15 be here. Thank you.
16 CHAIR PARSKY: Thank you very much.
17 Next, Nick Berardino.
18 MR. BERARDINO: Thank you.
19 First, on behalf of the members of our 17,000
20 Orange County Employees Association, we want to thank the
21 Commission for coming to Orange County. And thank you
22 very much for the opportunity to speak on this very
23 important issue. And we want to, on behalf of our
24 members, welcome you to Orange County.
25 The big two issues, of course, are pensions and

1 retiree medical. And we think we need to get back to
2 basics and take a look this whole pension issue. And we
3 know that pensions are there to provide security and to
4 provide it economically and DB plans also provide
5 investment capital, and without a whole heck of a lot of
6 fees in comparison to the fees of DC plans, where -- as
7 my favorite supervisor would say --
8 CHAIR PARSKY: I noticed you were groping for
9 the adjective. But that's okay, don't worry.
10 MR. MOORLACH: Thank you, Mr. Berardino.
11 MR. BERARDINO: You know, who are making
12 enormous money on those fees. And, you know, it goes to
13 reduce the need for government assistance in the later
14 years, where if you don't have a sound pension program,
15 you're going to pay for it in terms of other benefits.
16 And it does provide incentive for experienced workers.
17 On the differences between the public sector
18 and private sector, we see more the private sector
19 shifting to defined contribution plans, while primarily
20 in the public sector we have more of the still defined
21 benefit plans that dominate. And one reason, of course,
22 is we have such a large, diverse workforce in terms of
23 government, all kinds of jobs. You need, I think,
24 something that's going to attract those.
25 And I think one point here that we keep talking

1 about the private sector, the private sector -- all of us
2 have friends in the private sector -- they say, "We have
3 nothing. If we're going to retire, we are going to have
4 nothing." And I mean, I even have friends at a soccer
5 game whom my little Italian mother said, "Dominick, don't
6 get him," because he kept pulling on me saying -- I don't
7 mean to pull on you (*referring to Moorlach*), but keep
8 pulling on him, saying, "You know, we don't have
9 anything, we don't have anything."
10 And I really got upset, saying, "Well, then you
11 should go get something. Don't say, 'Hey, look, we're
12 dying, we're drowning,' so look, all of you come down
13 with us." I don't know, what sense does that make?
14 We also think that, you know, the defined
15 benefit plans are financially viable -- I mean, have
16 financial viability for employees that are efficient, and
17 they pool the risk. And I think that's very important.
18 Because you know what? We are living longer, and that's
19 true. But if you outlive that defined contribution plan,
20 there comes a time in your life where you have nothing,
21 and you will have to get public assistance. And it will
22 be constantly in the end.
23 And certainly our defined benefit plan here in
24 Orange County is very strong, very solid. And you can
25 see by the returns, one year, 13.55 -- we'll go to the

1 14 and a half years and it's almost 10 percent, our
2 assumption rate is only 7.75 percent.
3 And so it's over the long haul. It's not just
4 this picture of, "Well, let's take a look at a few bad
5 years." And we included in our comparison here some of
6 the bad years.
7 And we have a very, very low risk portfolio.
8 Among 84 funds, I think we were one of the lowest risks
9 that exist.
10 What role does the public play? It's commonly
11 thought that the employer assumes most of all of the risk
12 in defined benefit plan. That's just not true. We took
13 a period of time from 1994 to 2005 so we could have some
14 really horrible years in here, and take a look at
15 basically who's really taking on the risk. And as you
16 can see, between the employee contribution and the
17 investment returns, and people talking about 70 percent,
18 that's a number that seems to escape people. You know,
19 that risk is being taken on and paid for by the employees
20 and investments. And there's just a couple of charts
21 that I think are critical to that.
22 And one of the things that's very important to
23 us is that we have a very disciplined funding plan in
24 place, and it has worked. You know, all three components
25 of this funding plan have worked. You can see by the

1 numbers we've flipped on the screen are working. The
2 investment, the employees, and the employer, you know,
3 are all working. And we think that is very critical.
4 One of the things about the defined benefit
5 plan, retirement income is the largest risk, pooling that
6 risk. And that's something we're all used to, I mean,
7 whether it's car insurance, health insurance, life
8 insurance, we all pool that risk.
9 And no one would say, "Hey, let's get rid of
10 car insurance, health insurance, or life insurance." I
11 mean, it just doesn't -- it doesn't make sense. The plan
12 is very efficient, has lower fees, better returns, and
13 avoidance of the hidden costs, which is creating that
14 second-class citizen.
15 So the list goes on.
16 And I'll slip over the slide to quickly get to
17 the retiree medical plan. You've heard a lot about that
18 in Orange County. That is a very difficult thing, as you
19 heard from our retirees. And I can tell you that
20 definitely the plan is not perfect.
21 And our problem was we built that plan based on
22 having advanced earnings, from the pension plan when
23 those advanced earnings ran out we were down to
24 $39 million left in the plan, and we had to do something.
25 And it obviously didn't make everybody happy.

1 I have a neighbor who is a retiree who has,
2 since that plan, walks her dog and always stops at my
3 lawn. And I have gotten the message, and it's not
4 helping.
5 The fact is that we had to -- and we thought we
6 did -- meet the goals of maintaining viability in a plan
7 that was not adequately funded for the long-term. And
8 that was a tough issue. But how we did this, some of the
9 key features of the plan, we did separate the health
10 insurance pool for retirees effective 1/1/08. This is
11 going to have a major impact on them. It was a very hard
12 thing to do. But, you know, again, with $39 million
13 left -- and, candidly, in a very conservative
14 jurisdiction and, candidly, have a very conservative
15 board of supervisors, you know, you have to make very
16 hard decisions, and these were tough decisions. But
17 separating that pool will affect our retirees and
18 increase their costs. However, we have been told by the
19 county and I think our board has been very diligent,
20 saying, "We need to see a special plan for retirees
21 that's developed." Maybe you can take well-baby checks
22 out for most of them, and you can take some of those
23 other kinds of things out for them that will help reduce
24 the costs.
25 So the county will fund the new retiree plan.

1 We had an employee contribution of 1 percent, which will
2 stop. The retiree medical grant had a cost of living
3 part to it which was about -- it has been reduced down to
4 3 percent from 5 percent. A retiree medical grant is
5 reduced for retirement before age 60. This was an
6 incentive to get people to work until they were 60. You
7 lose 7 and a half percent of your grant every year before
8 60, except for the safety members who we represent who
9 did not have that component in their grant.
10 In general, the retiree medical grant for all
11 other and future retirees will be reduced by 50 percent,
12 when they become eligible for retiree medical care.
13 Now, the one thing, if you work longer than 60,
14 you get 7 and a half percent added on to the grant. So
15 that was something to incent people to participate. We
16 put it in a trust, which reduced the GASB problem. And,
17 you know, we're hopeful, it's not everything, but in our
18 view, it was a way to save the program.
19 The 1994 bankruptcy was a problem for us,
20 obviously. We think that there's no sense in creating
21 unnecessary fears.
22 There is a discussion about the county
23 wobbling. The county is in outstanding shape. In
24 fact -- and with the DB plan and with the retiree medical
25 plan, Standard & Poor's upgraded the County several weeks

1 ago to, I think, an AA- rating, so we have one of the
2 highest in California. Our board of supervisors chairman
3 said the state of the county is very strong.
4 We refinanced our bankruptcy debt in 2006, and the county
5 budget allows for more positions. So we have done
6 extraordinarily well. We think it just is plain common
7 sense that we maintain the defined benefit plan, the
8 pension plan is working in Orange County. There's no
9 need for a second tier because it's working, and we just
10 need to continue to let it work.
11 And thank you very much.
12 CHAIR PARSKY: Thank you.
13 Dennis Danner and Dick Kurth.
14 MR. DANNER: Good afternoon, Commissioners. My
15 name is Dennis Danner. I'm the administrative services
16 director for the City of Newport Beach. And I'd like to
17 present to you today what the city has done to address
18 the retiree medical issue in our city.
19 I'd like to acknowledge to my left, Dick Kurth,
20 who is my deputy. He was most instrumental in developing
21 this plan. And I'll try to be very brief.
22 What we'll cover today is an introduction and
23 overview, a description of our old program, a description
24 of our new program, the transition plan that we went
25 through, the outside support that we had and some of the

1 tools that we used to develop this plan.
2 The catalyst for the plan, of course, was the
3 employees wanted an increased benefit due to rising
4 medical costs. And I'll describe our old plan in just a
5 second.
6 And, of course, the city wanted a new structure
7 to limit our future unfunded liability.
8 So what happened? We converted our existing
9 retiree medical defined benefit program to a defined
10 contribution program. This was done through the
11 meet-and-confer process, and this is very important, it's
12 been mentioned several times today. And it was a complex
13 issue, like trying to compare apples to oranges. The
14 communication and explanation effort was critical.
15 It's favorable to the city because it
16 permanently capped the unfunded liability. It was a more
17 efficient use of our resources. And it was favorable to
18 the employees because it gave them an enhanced program
19 and offered more flexibility.
20 Very briefly, so you understand what we were
21 facing, our old program provided a benefit, a defined
22 benefit of $400 per month. The cost was shared between
23 retirees, active employees, and the city. It was usable
24 only for the city's medical insurance. It took seven
25 years to vest. And most importantly, you must retire

1 from the city to participate.
2 Problems with the old program, of course, was
3 the $400 a month maximum. There was no flexibility. You
4 had to work seven years to retire from the city to
5 receive any benefit.
6 There's no tax advantage for funds paid in.
7 They were paid in on a post-tax basis.
8 And a large percentage of those who paid in
9 along the way got nothing. It was a pay-as-you-go plan.
10 And if you work for the city for 20 years and left the
11 city to work for another agency, you got nothing.
12 The city, of course, problems the city faced
13 was the unfunded liability. We faced pressure from our
14 labor organizations to increase the benefit. It was
15 understandable because of rising medical costs, but it
16 was a big concern for the city. And it was inherently
17 unfair that we realized that you could pay into it for a
18 long period of time and never receive a benefit.
19 We first had an actuarial study done back in,
20 we believe, 1998. And at that time our unfunded
21 liability was about $14 million. And that was before
22 anybody even heard of the word "OPEB."
23 Our new plan, it's an "integral part trust" set
24 up under IRC section 115. It is a defined contribution
25 plan. Each employee has an individual account. It's

1 their account. If they leave city service, they take
2 that with them. The funds belong to the employee. And
3 the city's health insurance, of course, is still
4 available to those employees, but is not necessary that
5 they use the city's insurance. If they have alternate
6 insurance through a spouse or something, the money can be
7 used to make co-pays, deductibles, or help pay the
8 premiums of those plans.
9 There are three ways to get money into the new
10 plan.
11 The employee, as part of the salary
12 negotiations, and all employees agree to give up
13 1 percent of the projected salary increase, and that's
14 now deposited to their retiree medical plan.
15 Part B, contributions, the city places $1.50
16 per month to each employee's account based upon years of
17 service and age. And that initial deposit goes in after
18 five years of employment.
19 And then employee group by employee group can
20 choose to put some of their -- leave some of the proceeds
21 into the plan.
22 Very important, contributions to the plan are
23 pretaxed. And the way that that is accomplished, they're
24 mandatory and uniform for all employees within a
25 bargaining unit. There's no individual choice. If you

1 get any individual choice, even if it's a one-time
2 irrevocable, then they're not tax favored.
3 Here's an example of an employee who is 32
4 years old and has worked for the city for eight years,
5 the salary is $7,000 per month, 1 percent of that salary
6 is $70. That goes into the plan. 32 years of age plus
7 eight years of service is 40. So $1.50 times 40, is $60
8 goes into plan. The monthly deposit is $130.
9 It was very important, we had highly-paid
10 employees that preferred that the contribution be
11 strictly a percentage of salary. Of course, we had
12 lower-paid employees that preferred a flat dollar amount,
13 because health insurance costs the same for everybody, no
14 matter how much you're paid.
15 And so we came up with this compromise, that it
16 actually addressed both groups.
17 And I'll move very quickly here.
18 Investments are directed by the employees
19 within parameters provided by the city. The city has
20 an investment committee. It's very similar to a
21 deferred-compensation plan, where we offer, I think,
22 19 different investment options. The employees -- and
23 they're conservative -- and the employees pick which
24 ones they want to participate in.
25 (*Dr. Ghilarducci briefly left room.*)

1 MR. DANNER: Withdrawals from the plan can be
2 for any authorized medical expense as authorized by the
3 IRS. And any earnings in the plan, any withdrawals from
4 the plan are non-taxable at time of withdrawal.
5 Authorized participants to the plan -- this is
6 important -- it's the retiree, the retiree's spouse or
7 legal dependents. Funds remaining in the account, if
8 any, after death of the authorized participants are
9 reverted to the plan. This is the IRS's rule. This is
10 not the city's rule. We thought it to be a deal-breaker
11 when we first proposed it or when we first found out
12 about it. But we were told by the experts that it's
13 really not an issue. The issue is, you'll run out of
14 money before you will die or not be a participant in the
15 plan any longer.
16 That transition plan is probably the most
17 important part of this whole story, what we struggled
18 with the most. Existing retirees, they were not a
19 problem. They remain on the old plan. Newer prospective
20 employees, of course, were mandatorily rolled in the new
21 plan. It was the current employees that we had to deal
22 with and make it fair for all. And we struggled with
23 this for a long, long time.
24 Finally, we came up with the age-plus-years-
25 of-service concept. And as you can read on the slide,

1 age plus years of service totaling 49 or less you had to
2 convert to the new program, and that's 45 for public
3 safety employees because, of course, they retire sooner.
4 If your age plus years of service totaled 50 or more, 46
5 for public safety, then you were given the option to
6 fully convert to the new program or participate in a
7 hybrid program with elements of both.
8 And the reason for that was, we have many older
9 employees that didn't have enough time left in their
10 careers to make that defined contribution plan
11 meaningful, so we developed a hybrid plan. And because
12 of the provisions of the old plan, where if you left city
13 service -- for an example, if you had a 45-year-old
14 employee who had ten years of service, they might
15 choose -- and some did -- to go to the new plan, the new
16 defined contribution plan simply because as part of the
17 contributions to the -- you'll see on the next slide --
18 if you chose to stay on the old plan, then you had $100
19 per month contribution co-payment.
20 Plus, the fact that if you're 45 years old, you
21 don't know if you're going to retire from the City of
22 Newport Beach.
23 *(Dr. Ghilarducci returned to the room.)*
24 MR. DANNER: If you have aspirations to become
25 a police chief somewhere and you may not stay with the

1 city, so you could choose to convert to the new plan.
2 The hybrid program, which I just described, is
3 temporary, it's a one-time option for relatively older
4 employees. They participate in the new program but
5 retain the $400 per month provision of the old plan.
6 They do not receive the city's $1.50 per month for age
7 plus years of service. And as I mentioned, they must pay
8 in $100 a month to remain on the old program. If you
9 have 20 years left in your career, and you would think
10 long and hard about whether you want to stay with the old
11 program or go with the new one.
12 In the end, this age-plus-years-of-service we
13 came up with was probably not necessary because people
14 just fell out naturally with very, very few exceptions.
15 We had about a 50-50 split of who converted to the new
16 plan. And our average age of our workforce is over
17 44 years of age. And yet over half chose to convert to
18 the new plan.
19 We had to get a lot of outside support to
20 implement this. The attorney we found, her name was
21 Shana Saichek, very knowledgeable in this field. She has
22 worked extensively in Orange County. She is licensed to
23 practice law in the state of Washington, the state of
24 New York, and the State of California. And a lot of her
25 work is done in California.

1 We contacted an actuary whom some of you may
2 know, John Bartel. He's speaking later this afternoon,
3 or scheduled to.
4 We tried to find somebody that would be both
5 a trustee and a custodian as well as a claims
6 administrator, and believe it or not, we couldn't find
7 anybody in the entire nation that would do both.
8 But we did find two companies that partner with
9 each other, ING, who is one of the largest financial
10 companies in the world, and a company out of Minneapolis,
11 their abbreviation is ARC, Administration Resource
12 Corporation. And they do our claims administration.
13 We're, as we speak, searching for trustee custodian. We
14 talked to Ken Marzion this morning. We understand that
15 we may choose PERS as our fund.
16 This is our Cost Estimation Worksheet. And
17 I've only got a couple of slides left. When we went
18 through this, we went through many, many, many iterations
19 of this program, too few to mention. And if we had to
20 hire an actuary to go through each of the iterations, it
21 would have been cost prohibitive and just wouldn't have
22 been workable. So we came up with this Cost Estimation
23 Worksheet.
24 And you can see a black line that goes
25 horizontally through the center of it. That separates

1 many rows below. You can also see lines, vertical lines
2 to the right, and that separates many columns.
3 This work sheet is actually over 1100 rows long
4 and 75 columns wide. And what we attempted to do here
5 was list all 1100 rows, we listed all current employees
6 and retirees. It also captures age, length of service,
7 likelihood of retirement, probable retirement dates,
8 projected life expectancies, projected pay raises,
9 projected payments into the old plan and new plan,
10 projected cash outflows, rates of return, et cetera. And
11 so every time we came up with a new iteration of the
12 program, we could plug the numbers into this and get a
13 good cost estimation of what this program was going to
14 cost.
15 We did run this by our actuary, John Bartel,
16 who did not perform an actuarial study on it, but he gave
17 a reasonableness check and gave us his blessing.
18 We also developed interactive work sheets on
19 the city's Web site so that employees could make an
20 informed decision of which program they wanted to go
21 into.
22 In this example given, this is for somebody who
23 is converting to the new program. They were hired in
24 1999 -- this is just a hypothetical example -- hired in
25 1999 at age 23. They estimate that they can retire in

1 the year 2034. We estimate annual COLA increase for
2 salaries of 2.75 percent. And this is all interactive.
3 They can change the assumptions. Any of the blue boxes,
4 you can change the assumptions. And if you look down at
5 the very, very bottom right-hand corner, you'll see that
6 with all the assumptions that we've assumed here, that
7 this employee will have $1,233.87 retirement. And that
8 will pay for retiree medical, even monthly payments over
9 a 30-year period. And, again, the 30 years, there will
10 be zero left in this individual's account.
11 I realize that in the year 2035, $1,233 may not
12 be a lot of money, but it's better than the $400 by far.
13 So just in conclusion, for the employees, this
14 guaranteed participation, guaranteed flexibility, it gave
15 them tax-free money, both going in and coming out, as
16 well as the investments within the account.
17 From the city's standpoint, it permanently,
18 once and for all, capped our liability for retiree
19 medical. It will never get one dime bigger than it is
20 today.
21 Reduced risk, it is a more efficient use of
22 funds. But in reality, there's no free lunch. It's just
23 a different way to address the cost. It's essentially
24 prefunding our retiree medical obligation rather than
25 putting it on a pay-as-you-go basis and forces more of a

1 "pay full labor cost" as services are received, rather
2 than after you retire.
3 Finally, is it adaptable elsewhere? We believe
4 it is, at least some aspects are applicable to probably
5 agencies' situations. But, again, I want to stress, it
6 was done through the meet-and-confer process, it was
7 dealt with the issue as part of the overall compensation
8 issues. It was a problem-solving approach rather than
9 focusing on employees as being adversaries. It was
10 approved by a strong margin of every employee
11 association.
12 And finally, the education and explanation effort
13 was essential. Dick and I sat down with hundreds of
14 employees and walked them through this process, and
15 helped them make an informed decision, and it had
16 advantages for everyone.
17 And that concludes my presentation.
18 CHAIR PARSKY: Thank you very much for that
19 presentation.
20 Last, Eric Hall. And then we'll have some
21 questions.
22 MR. HALL: Mr. Chairman, Members of the
23 Commission, thank you very much for the opportunity to be
24 here before you today.
25 My name is Eric Hall. I current work as the

1 deputy superintendent for Business and Support Services
2 for the Capistrano Unified School District.
3 Prior to working for Capistrano, I was with the
4 San Dieguito High School District down in the north part
5 of San Diego County for 27 years, and prior to that, with
6 San Diego Unified. I retired with 32 years of public
7 school district experience, and currently work as a
8 policy and fiscal advisor for many districts, including
9 Capistrano Unified.
10 I think it's really great that you have invited
11 a school district representative to be here before you,
12 because the numbers, for example, with just Capistrano
13 Unified are pretty daunting. For example, 55,000
14 students, 65 school sites, an annual operating budget of
15 $390 million. 3,900 employees. An annual pay-as-you-go
16 obligation for OPEB at 1.1 million. And as a result of
17 our newest actuarial study, ongoing costs for employee
18 retirement benefits in the $54 million range. That's
19 simply one school district in South Orange County.
20 Education, as many of you know on the panel, is
21 a very big industry. And I think it really deserves a
22 place on this panel and really deserves some time and
23 light of day before you. And I appreciate an opportunity
24 to talk to with you.
25 I'd like to share with you just some thoughts

1 in three areas.
2 Number one, fiscal.
3 Number two, employee pension benefits for
4 schools.
5 And number three, the school district solutions
6 and potential options that school districts face.
7 I think the fiscal situation for schools are
8 rather unique. Schools in many ways are driven by the
9 state, driven by the state revenues; but the operational
10 characteristics of school districts are really quite
11 unique. Schools are strictly attendance-driven. We get
12 about 75 percent of our revenue based on average daily
13 attendance. So as a parent, there's no surprise when
14 your kid isn't in the school, you get a call from the
15 school to determine whether or not your kid has an
16 excused absence. We put a lot of resources in counting
17 kids, in counting attendance.
18 For example, at Capistrano, enrollment there
19 generates $5,570 per student. In San Dieguito being a
20 high school district, we received about $6,300 per kid.
21 So we do a lot of things in schools to maximize
22 funding to the best that we can.
23 As chief business officials in schools, we talk
24 a lot about enrollment, we talk a lot about creating
25 schools of choice, we talk a lot about trying to do open

1 enrollment and bringing kids back in from private
2 schools, limiting the amount of kids that go out into
3 charters, giving parents choices, and certainly looking
4 at enrollment and trying to do what we can to increase
5 attendance, because attendance is really the lifeblood of
6 the school district organization.
7 We also do a lot of other things. We
8 participate in categorical funding, we create
9 foundations.
10 Mr. Chair, in the area where you live, the
11 school that serves your area is one I work with very
12 closely, Torrey Pines High School, that enjoys the
13 reputation of being the number one foundation in the
14 state of California where parents there generate about a
15 million dollars a year for the high school of 3,200 kids.
16 Very unique, very fortunate to have that resource.
17 School business offices around the state look
18 at those kinds of foundations to supplement school
19 funding, look at joint-use projects with my colleagues
20 and cities and counties. We look at something called
21 asset management. We look at lease income. And
22 certainly today, declining enrollment as an issue facing
23 about 50 percent of the schools in the state of
24 California is an issue that needs to be looked at and
25 needs to be reformed before schools are required to pay

1 on an ongoing basis for their pension obligations.
2 For example, just some quick numbers, with
3 30 students in an individual class generating about
4 $5,000 per student, the quick math on that is $150,000
5 per classroom per year, provided all those kids are in
6 school 182 days. And then we don't get dinged forty-plus
7 dollars a day for each absence.
8 When we reduce -- when we're growing in
9 enrollment, the growth is great. It's additional
10 revenue. Out of that $150,000 of additional revenue we
11 would add a teacher. We might add an instructional aide,
12 a computer, some books, teacher's salary and benefits
13 being in the range of about fifty to sixty-five thousand
14 dollars in the beginning. If it's not a special ed.
15 class, we don't have to hire an instructional aide; we
16 have got extra money. We can do a lot of things on that
17 float.
18 However, when you're declining in enrollment
19 and you lose those 30 kids, and you lose that $150,000
20 per class -- and, of course, students don't leave in nice
21 packages, a fifth grade with all 30 leaving at one
22 time -- the staffing there does become a real challenge.
23 But when you decline and you lose $150,000 and you lay
24 off that teacher or reassign that teacher, you lose that
25 sixty, sixty-five thousand dollars. You've got to take

1 the balance of that funding out of your operational
2 budget. That becomes a very big challenge for school
3 districts.
4 And I'm saying this as sort of an introduction
5 to the benefit challenge because we're 85 percent people.
6 Of the $390 million in the Capistrano budget, 85 percent
7 of that is in employee benefits and employee salaries.
8 So whenever we're reducing, we're talking about reducing
9 people, reducing programs, and declining enrollment
10 really needs to be looked at. Most educational
11 associations have lobbied for this for the past couple of
12 years.
13 And before we get into requiring through
14 legislation for school districts to have to set aside
15 money and long-term pension obligations, we've got to
16 focus on that issue.
17 The second point on benefits. Benefits as a
18 part of compensation packages are totally locally driven
19 through collective bargaining. As Mr. Lipps and Mr. Hard
20 and Mr. Low and certainly Mr. Cottingham know, collective
21 bargaining is a local issue in school districts. So
22 we've done a lot of things locally. And I've been
23 involved over the many years in terms of preparation for
24 negotiations, collecting data, actually structuring the
25 form of contracts and the structure of benefits. We've

1 done a lot of things in schools to try to minimize the
2 impact of retiree benefit coverage. Many schools have
3 capped retiree benefit coverage at age 65. Many schools
4 have capped the district's contribution to the premium
5 that was applied at the time when the employee retired.
6 Many districts have required employees to have
7 15, maybe 10, 15, 20 years of service before they're
8 eligible for these kinds of costs.
9 And when you look at the total dollar amount,
10 there's no wonder why that is not an issue at the
11 negotiating table.
12 But that is strictly a local issue. Very
13 difficult for a school district to force that
14 unilaterally. It's a give-and-take process through
15 employee negotiations.
16 Now doubt that this long-term obligation is
17 something that needs to be addressed. And I applaud you
18 and the Governor for attempting to get your arms around
19 it.
20 Those of us in the school business, who have
21 survived the business over the years, know what the
22 disease called "*muralitis*" is. "*Muralitis*" is a
23 condition you have when you can't read the handwriting on
24 the wall. Those of us in schools know what's coming down
25 the line. We know by virtue of the fact that we're

1 required now to identify the obligation. And we're
2 sun-shining with that obligation. It's not much further
3 down the track to require districts to figure out a way
4 to fund these.
5 So we've been talking as a group of school
6 business officials around the state. We've talked about
7 a number of solutions. We've talked about accruing
8 obligations, perhaps not 100 percent of the obligation,
9 but accruing a portion of that obligation annually.
10 We've talked about funding an annual amount,
11 for example, a percentage of the obligation, or a dollar
12 amount of the obligation, depending upon the district's
13 ending balance.
14 Another option is to look at charging allowable
15 costs out to special programs. School districts get
16 special money for transportation, food services, adult
17 education, preschool, special ed. facilities. If we're
18 going to be asked to fund employee retirement,
19 post-employment retirement benefits from the district,
20 we will look at how we can fund those benefits from the
21 variety of funding sources we get. And guess what that
22 means? That means fewer people in transportation. That
23 means fewer people in special ed. It simply is going to
24 have an impact on the level of service that we'll be able
25 to provide.

1 Another thing we've looked at is setting aside
2 a reserve in our general fund. Right now, we don't have
3 to set aside a special reserve, although many
4 organizations have looked at a one-way door of creating a
5 trust. You put the money in, the accrued interest on
6 that helps fund the obligation. Some districts are
7 looking at setting aside a separate amount in their
8 general fund. It gives them more flexibility, at least
9 setting aside a reserve on a part-time part of the
10 accrual basis.
11 And then the other aspect that you should be
12 aware of that many of us who work in schools and some of
13 us that have more than one address in school see a number
14 of flyers, we see a number of workshops. We get called
15 on regularly by banks and underwriters. A new trend now
16 in the banking industry, and particularly among those
17 school districts that are familiar with bonding for
18 facilities, is bonding for the obligation.
19 I recently got a letter in Capistrano Unified
20 from an underwriter that said, "Let us help you. Your
21 obligation of some fifty-plus million -- guess what? --
22 we can keep that payment at a million dollars a year."
23 Of course, it's going to go up 30 years. Of
24 course, it's going to cost us 80 million in the long run,
25 but we're being marketed to now by banks and underwriters

1 in this area.
2 I guess in conclusion, I would just say that
3 we realize that this obligation needs to be recognized.
4 There's some uncertainty in what it means now that this
5 obligation that is unfunded will show up on our annual
6 audit. We don't know what that's going to mean on Wall
7 Street when we go to bond or go to borrow.
8 It is a complex issue, particularly for
9 schools. I've just glossed over some really large and
10 complex issues related to school funding, related to
11 collective bargaining.
12 Three numbers for you: 6.2 million, 655,000,
13 and 1,100.
14 6.2 million students in the state of
15 California, 655,000 school employees in the state of
16 California, and 1,100 school districts in the state.
17 My recommendation to you would be to spend some
18 time to bring the experts in to work through the county
19 office, to work for the State Superintendent of
20 Instruction, to work through a variety of other school
21 district organizations. And I would strongly recommend
22 that you hold a special hearing, just looking at the
23 impact on schools, because it is unique, it is large,
24 it is more than twice the size -- or approximately twice
25 the size of the state program as the state has 350,000

1 employees, we have 360,000 teachers alone. And in
2 addition, another 300,000 classified or support staff.
3 So those are just some quick comments for you
4 in three areas.
5 Again, I really appreciate an opportunity to be
6 here with local government to talk a little bit about the
7 school impact. And I would welcome your questions and
8 further dialogue on the impact of this on schools.
9 Thank you very much.
10 CHAIR PARSKY: Thank you very much.
11 And I want to thank all of the panelists.
12 Now, we'll open it up to some questions.
13 John, do you want to start us off?
14 MR. COGAN: Thank you, Gerry.
15 And thank you all for coming and sharing your
16 excellent work with us.
17 One thing that struck me throughout this
18 hearing is the importance of local control. It does seem
19 to me that you can't separate solving this problem from
20 collective bargaining, you can't separate from the
21 particulars of the workforce that is receiving the
22 benefits, and from the particulars of the community.
23 And so the idea of local control seems to me to be a
24 profoundly important idea as the Commission develops its
25 recommendations down the road.

1 I agree that defined benefits plans have their
2 attractiveness. But in the public sector, they seem to
3 have a significant problem. The time horizon of elected
4 officials seems to be a lot shorter than the time horizon
5 of the workers. And so you tend to get underfunded
6 plans, which is why we're here today, be they pension
7 plans, be they health benefit plans.
8 So while I see the merits of the DB plans; I
9 also see in the public sector this kind of systematic
10 problem.
11 And so, Mr. Moorlach, when you mentioned in
12 your presentation that San Francisco has a well-funded
13 plan, and it requires that the voters vote for any
14 benefit enhancement, I think is the way you put it, I was
15 struck, until I had two questions related to that issue.
16 One is, are the benefit levels provided to retirees in
17 health care or in pensions lower in San Francisco, about
18 the same in San Francisco, or above in San Francisco
19 relative to other municipalities of similar
20 characteristics? That is, has the solvency been achieved
21 at the price of lower benefits for workers and retirees?
22 And the second question is, are there any other
23 municipalities or special districts or whatever that
24 require a similar vote of the public in order to enhance
25 benefits as a way of getting around what I see as this

1 endemic problem that politician's time horizons are
2 shorter than the time horizons of the workers?
3 MR. MOORLACH: Those are great questions,
4 Mr. Cogan. I'm not sure I can give you precise answers
5 on San Francisco. I have not looked at their formulas.
6 But I will tell you that their Deputy Sheriffs
7 Association put a ballot measure on to improve their
8 benefits to comparable -- to the rest of the state, and
9 the voters approved the benefits.
10 So it certainly isn't an impossibility to get
11 your benefits to where maybe other municipalities are at.
12 So from that anecdotal fact, I'm sure their benefits are
13 probably rather similar.
14 San Diego City, who just had an election in
15 November, and made a change to their pension plan, I
16 believe it was either Measure A or B, I apologize. But
17 they, I think, now require a vote as well.
18 CHAIR PARSKY: I think that's a piece of data
19 that would be helpful to collect and make sure that we
20 provide that to the Commission Members.
21 MS. SHEEHAN: Yes.
22 CHAIR PARSKY: Any other questions of this
23 group?
24 Yes, Dave?
25 MR. LOW: Just in follow-up to that comment

1 about local control. I heard that pretty consistently
2 across the panel.
3 I'm curious about Mr. Moorlach's position on
4 that issue. Because you recommended a number of
5 solutions that appeared to be a mixture of local issues
6 and statewide imposed solutions. And I notice that there
7 is a locally negotiated resolution to this GASB issue
8 that some people are unhappy with.
9 What is your position with regard to local
10 control as opposed to statewide proposed solutions?
11 MR. MOORLACH: It's twofold, Mr. Low. The
12 first is we certainly need to work with our bargaining
13 units and our employees. It is a home issue that we need
14 to deal with.
15 And I just probably want to maybe acknowledge
16 the great job that Mr. Berardino and Mr. Kerr have done
17 with their respective unions in the county. They
18 certainly are suffering from the same arrows that are
19 coming our way, as supervisors.
20 On the other hand, if you sat down and reviewed
21 all the empirical data, and if you've chartered out the
22 numbers, and if by some chance you concluded that
23 defined benefit plans as they are currently structured
24 with the benefits in place, if you decided those are
25 unsustainable, and you decide, well, we'd better go with

1 a defined contribution plan, if we decided that
2 independently, that would be extremely difficult to do
3 locally. It would be very helpful to have a statewide
4 initiative that said, "Here is what it's going to be for
5 everyone" because the issue then would probably be
6 recruitment. Why would I work for Orange County when I
7 can work down the street in San Diego County or Riverside
8 or San Bernardino, and get a DB versus a DC if they
9 perceive the numbers don't work out?
10 So there is a lot of room for a statewide
11 solution.
12 MR. LOW: And with regard to this question of
13 DB/DC, the Commission just received a report recently
14 from CalPERS, they, I guess, commissioned a study from
15 the CSU Applied Research Center that talked about the
16 financial footprint of this defined benefit plan. And
17 I'm just curious about whether you looked at that issue
18 locally. Because I noticed that it talks about
19 $21 billion economic activity generated each year just by
20 the pension payments and investments of the retirement
21 systems.
22 Have you looked at that with regard to Orange
23 County specifically or --
24 MR. MOORLACH: Thank you, Mr. Low.
25 I have scanned the report. I think the answer

1 would be the same, whether it would be DB or DC, we're
2 still going to have funds being invested throughout the
3 community, the country, and the world. So I think the
4 footprint would be pretty close.
5 In the private sector, we now have more DC
6 funds under management than we have DB plans. So we're
7 already seeing a trend in that direction; and I don't
8 think that's going to change the economic impact, whether
9 it's one type of trust versus another.
10 MR. LOW: A question for Mr. Kerr.
11 MR. KERR: Yes?
12 MR. LOW: Have you experienced any sort of
13 morale issues with regard to your new hires being in this
14 new HSA plan?
15 MR. KERR: No. It's too early to tell. It's
16 only been implemented as of January 1 of this year. But
17 we understand that if you have three or four people on
18 a fire engine and they're in different retirement tiers
19 or they're in different retiree health-care tiers,
20 eventually there could be the potential for friction,
21 especially when those people in the DC plan become the
22 majority and I'm their boss -- they're my boss, I'm
23 sorry. They come to me, and they say through surveys,
24 "We want you to make us whole." So before you can move
25 the ball down the field, you have to really research that

1 and make them whole.
2 So we haven't experienced anything yet; but
3 there's a potential out there for it, that's true.
4 MR. LOW: And I noticed that you included the
5 California Professional Firefighters --
6 MR. KERR: Yes, sir.
7 MR. LOW: -- principles there. And so one of
8 their principles was with regard to no two-tiers. So I
9 guess there's some conflict between what you did there
10 with the statewide principles there.
11 MR. KERR: Yes, I would say we would have
12 preferred to stay in a defined benefit plan, all things
13 being equal, we would have done that for all of our
14 employees.
15 But we didn't have that option. When they
16 said, "We're running out" -- our employer said, "We are
17 running out of money. And in eight months, those
18 retirees will not have retiree health-care coverage," we
19 had to do something. And we did something with the
20 available revenues we had, and that was one of the
21 limited options available to us.
22 So I believe in those tenets, and I believe in
23 those principles that we put forward, that the state
24 counsel also mimics.
25 But, you know, sometimes the bankruptcy was

1 external influence that we had to deal with; and it seems
2 like we're still dealing with the aftershocks of that
3 even a decade later.
4 So I believe in DB plans, I believe in locally
5 negotiated contracts, I believe in securing long-term
6 benefits through your members, through the legal
7 collective bargaining process. And you have to work with
8 the available monies that you have.
9 MR. LOW: One last question to Mr. Hall.
10 You talked about the 655,000 school employees
11 and the fact that that's twice the number of the state
12 employees. Our research also shows that about half of
13 the school employees, teachers and classified employees
14 in school districts, receive no retiree health care at
15 all. And I was just curious if you've looked into that
16 issue and are your findings similar.
17 MR. HALL: Many districts require an employee
18 to work 40 percent time, 50 percent time to receive
19 benefits. It's strictly a local negotiated amount,
20 depending upon the bargaining unit and the fiscal
21 circumstances of the school district.
22 MR. LOW: Thank you.
23 CHAIR PARSKY: Bob?
24 MR. WALTON: Just a point of clarification.
25 The report from CalPERS and CalSTRS I understand only

1 covered the benefit payments made to retirees, it did not
2 cover the economic impact of investments. And that's to
3 come later. But I for one on the Commission would like
4 to see the authors of that report make a presentation at
5 some future Commission meeting, just so we clearly
6 understand the impact of that pension footprint, if you
7 would.
8 I know in Orange County there's some 10,000
9 CalPERS retirees living, and so I think that that
10 economic footprint is rather large here.
11 And I know CalPERS invests several hundred
12 million dollars in real estate, in homes, and other
13 companies in this area. So I think the impact of all of
14 that needs to be clearly understood by this commission.
15 CHAIR PARSKY: I think that's a good
16 suggestion.
17 Lee?
18 MR. LIPPS: Mr. Moorlach, I was intrigued by
19 your suggestion about completely open negotiations to
20 the public. This really wouldn't be the place to
21 discuss that.
22 But I'm a little bit more interested in your
23 statement that you believe that research shows that a
24 defined contribution plan is better than a defined
25 benefit plan. And you cite some research by the Pacific

1 Research Institute, which at least in my experience with
2 them, usually is not characterized as being non-partisan
3 or bipartisan. And I thought it particularly sort of a
4 counter to what Mr. Danner mentioned, that one of the
5 near deal breakers in this agreement with the employees
6 had to do with the fact that unused money after the
7 people that participated, either as the employee or the
8 spouse of the employee in retiree medical, but any money
9 that was left over would revert back to the trust, if I
10 understood that correctly. And you said, "Well, you
11 don't have to worry about that because you'll run out of
12 money before you die." And so I'd like you to explain a
13 little bit more, or at least are you aware of any other,
14 let's say, less partisan research that shows a defined
15 contribution system being better than a defined benefit
16 system in an average kind of system?
17 MR. MOORLACH: Thank you, Mr. Lipps, for the
18 question.
19 I have boxes of research. And I wasn't sure if
20 I should put all kinds of footnotes in my presentation.
21 I do apologize. I just tried to use a couple of
22 anecdotal supporting ideas.
23 I think you'll find some probably good studies
24 on defined contribution plans and their portability.
25 And you'll also find some interesting studies on

1 demographics on the various generations that we're using,
2 Gen X and others that may not stay with the employer for
3 the entire year, and would like the flexibility to move
4 in and out of private and public and carry those benefits
5 with them.
6 So I think that that is out there. And I can
7 try and look for you, but I've already taken a lot of
8 time today. But if you let me know, I'll go through the
9 boxes. I am still in boxes because I changed jobs. But
10 I can certainly try and do some Googling for you. But
11 I think that would be data that would be well worth
12 reviewing, especially if you want to give some options
13 for a new employee. You can either be in this plan or do
14 a DC. And if they have some short-term plans for their
15 career, then it might be preferable.
16 CHAIR PARSKY: Curt?
17 MR. PRINGLE: I just want to follow up on that
18 point. And, John, as other information is being provided
19 to the Commission, if you, through your boxes or Googling
20 efforts have the ability to provide any other
21 information, we all would be glad to get and read and see
22 what you have to share.
23 MR. MOORLACH: Well, maybe if I jump in,
24 Mr. Pringle; there is a Web site -- in fact, the
25 gentleman who manages that Web site is here today, and

1 that is called Pension Tsunami, and it also has a daily
2 clipping service. And if you're not already subscribing
3 or not aware of the Web site, it is an incredible
4 resource of just what's in the news that day around the
5 state, the country, and the world.
6 MR. PRINGLE: I just wanted to reiterate if, in
7 fact, this commission is always open to hear all that
8 stuff, because other members requested information be
9 distributed to all of us, that would be great if we could
10 have that distributed as well, if there are some specific
11 things that would clarify your points a little better --
12 or more, or add to them.
13 And I did have a couple questions, but I am
14 going to defer my questions after lunch.
15 CHAIR PARSKY: Teresa?
16 DR. GHILARDUCCI: I hate to stand between you
17 and your lunch.
18 MR. PRINGLE: Oh, go right ahead. It's okay.
19 DR. GHILARDUCCI: I have two questions. The
20 first one is probably for Mr. Berardino.
21 THE AUDIENCE: We can't hear you.
22 MR. PRINGLE: You have to push the button right
23 there.
24 DR. GHILARDUCCI: Thank you.
25 The first one is for Mr. Berardino and probably

1 for Mr. Hall.
2 Local control makes a lot of sense, not only
3 does it mean that the people most affected by a decision
4 have a say in that decision, they have more information,
5 they have more stake in it; it can be more efficient, it
6 can be more just.
7 But if local control is taken to its logical
8 extreme, it means that all of us are on our own, that it
9 gets reduced to the individual level, and then we lose
10 a lot of benefits we can get from solving solutions
11 together and having larger economies of scale.
12 So in your experience in Orange County and in
13 your school districts, you said that you were faced with
14 a decision because of shrinking resources and because of
15 your unique solution.
16 Would there have been, if you can think about a
17 world that you would have liked to have been in, anything
18 that the state could have done that could have helped you
19 come to a better solution than you did get to because you
20 had only your own resources?
21 MR. BERARDINO: Well, one thing the state could
22 do is when they give local government programs is send
23 the money along with it.
24 DR. GHILARDUCCI: Okay.
25 MR. BERARDINO: But beyond that, I think local

1 control -- the reason why I think local control is
2 important is because we are such a big and such a diverse
3 state, and there's so many different issues that affect
4 each group differently.
5 And also because our retirement plans
6 themselves are very different, and they're already set in
7 kind of a local arena, that without local control, you're
8 giving up the ability to use the leverage from those
9 individual retirement plans in terms of finding
10 individual solutions that work for the jurisdiction.
11 DR. GHILARDUCCI: Yes, but there was nothing
12 that you could have imagined that the state could have
13 had available to you, like a larger risk pool for your
14 retirees?
15 MR. BERARDINO: Well, that's --
16 DR. GHILARDUCCI: Or expertise that was
17 subsidized, so you don't have to go out and hire your own
18 actuary or your own lawyers?
19 MR. BERARDINO: We did that. And we did
20 explore the possibility of, on the pension side, going
21 with CalPERS and did a great job -- CalPERS did --
22 because we wanted to see if we were to pool, you know,
23 would that have better economy for us? And we did have
24 our own actuaries and we had PERS's actuaries. And all
25 worked very closely together, found out that it did not

1 have a significant impact on us.
2 DR. GHILARDUCCI: All right, do you have any
3 comments?
4 MR. HALL: Yes, ma'am. My comments on that,
5 thanks for the opportunity to elaborate, is that we have
6 the worst of both worlds in schools. We cannot raise
7 funds locally. We can raise funds locally for school
8 bonds for a capital purposes with a 55 percent bond, but
9 we can't raise local property taxes that go to school
10 schools. So we're tied to enrollment, we're tied to
11 formulas that are rather archaic, that are way different,
12 they're not equalized. We have a special ed. program in
13 Capistrano that's a $75 million requirement based on
14 local law and IEP's and attorneys and all the rest, and
15 it's funded to the tune of $35 million. So we have the
16 requirements in law and the local responsibility.
17 So I guess I would say that I wouldn't want to
18 be left on my own in a local situation. As a matter of
19 fact, that's where we are now. We need the support to be
20 able to raise revenues locally. We need programs that
21 are mandated by the state and federal government to be
22 fully funded. We need some reform in declining
23 enrollment, a soft landing over a period of years, as
24 opposed to a one-year drop. And I would recommend the
25 same kind of approach with any potential legislation in

1 OPEB, that if it's coming down the line and we're going
2 to have to fund the future liability, give us an
3 opportunity to have a soft landing on that over a period
4 of years.
5 Thank you.
6 DR. GHILARDUCCI: My second question is in
7 another area. It's been said among pension reformers,
8 that pension reform is done by men for pensioners who are
9 mainly women. And so I have a sense that what I don't
10 know as a commissioner is who the retirees are.
11 What happens -- I only know anecdotally from
12 some of the public commentary -- to living standards
13 among your retirees when they have to pay for medical
14 care? Who, among retirees, are most vulnerable to cuts
15 in retiree benefits?
16 So if someone could tell me among the retiree
17 groups that you know, what percentage of them are women,
18 and how does their median income differ to the rest of
19 the population or to the rest of the retiree group?
20 MR. BERARDINO: I can respond to that. And
21 thank you for bringing that point up because I think it's
22 very important.
23 In the county workforce, roughly now, women
24 comprise about 64 percent of the county workforce. So
25 if you apply some logic to that, one guess would be that

1 we have a large majority, a majority who are women.
2 In our county workforce, the women, because we
3 have a very large office services group, which comprises
4 about 3,000 people of the 18,000 people, there's a
5 large -- that group of employees are the least-paid of
6 the entire workforce -- very, very difficult to move
7 those salaries up -- who then have to come and live in
8 Orange County and pay enormous costs for rent.
9 And so there is no question, I think, that the
10 women are most adversely affected by the retiree medical.
11 CHAIR PARSKY: Paul?
12 MR. CAPPITELLI: Thank you. And I don't want
13 to be the one to stand between us and lunch, but I do
14 have a quick question.
15 CHAIR PARSKY: Two more, that's okay, and then
16 we'll break.
17 MR. CAPPITELLI: Thank you.
18 Supervisor Moorlach, this question is for you,
19 and this is in regards to your slide on issue number
20 three, where you talk about life expectancy and
21 decreasing retirement. I just had a couple of questions
22 on that.
23 First of all, what was the basis for your
24 remedy to go from age 50 to 57 for public safety members
25 and for 55 to 62 for general members? How did you arrive

1 at that new number?

2 MR. MOORLACH: Thank you, Mr. Cappitelli.

3 We need to look at doing something -- there's
4 already been some studies that show that if you can
5 extend the time working at your employer, that it reduces
6 the unfunded liability rather dramatically. We've done
7 some research in my office. I don't really have a long
8 answer on how those numbers were developed; but I believe
9 that this would have a good -- maybe a good starting
10 point for a discussion, but also a good way to start
11 reducing our unfunded liability.

12 MR. CAPPITELLI: I guess more specifically what
13 I'm really interested in is, was there consideration
14 given to health, especially with respect to safety
15 members? Because, you know, if you look back,
16 historically, as to how we came to arrive at the formula
17 for 3 percent at 50 right now for public safety, for law
18 enforcement and firefighters, it has a lot to do with
19 actuarial projections, life expectancies, things of that
20 nature.

21 I guess my specific question that I really
22 should ask you is, is the move from 50 to 57 a
23 dollar-driven move or was there any consideration there
24 for the life expectancy?

25 MR. MOORLACH: It's maybe a twofold answer.

1 But we are finding that from studies, that if you retire,
2 and you retire sooner or earlier, you will live longer.
3 That's one of the arguments for why you went from 55 to
4 50.
5 The second is --
6 MR. CAPPITELLI: I can't debate that. I would
7 have to agree.
8 MR. MOORLACH: I'm just telling you we've got
9 empirical studies that show it.
10 The second study is that if you are retired
11 with a satisfactory income, you will also live longer.
12 So these are just issues that -- you know, they just come
13 out of data that you see.
14 I think the issues we're seeing, especially as
15 you get into the upper echelons of police departments,
16 where we're seeing that you are hiring for your police
17 chief someone who is 46, 47, and while they're just in
18 the job and really getting there, they turn 50, and then
19 they retire, so you're losing some incredible wisdom,
20 experience -- just what you need, as your chiefs, your
21 captains, lieutenants.
22 Just recently my police chief retired, and
23 embedded in the article, it says, "and on Friday, he
24 turned 50." So I find it, as a manager, a real
25 heartbreak to see some incredible people leaving so soon.

1 Now, you started out, I believe historically,
2 1 percent at 50, and it worked up to -- you know, after
3 years, to 2 percent. A lot of anguish, and then
4 overnight it went to 3 percent, just like that, and then
5 it went retroactive.
6 So something is a little out of balance. And
7 so I'm just here to provide some debate points and say,
8 "What can we do, what can we put on the table," and
9 whether it's something else, that's fine. But I think we
10 should enter into dialogue.
11 MR. CAPPITELLI: I would just suggest to you
12 that they're not all retiring; they're actually going to
13 work back in the field, a lot of them. And they are
14 taking that expertise and putting it towards somewhere
15 else, which really kind of leads to my second question.
16 When you talk about or you mention
17 double-dipping. Can you explain what it is and how it
18 relates to the issue or the problem at hand?
19 MR. MOORLACH: Well, let me just give an
20 example. My assistant could retire at 55. He could get
21 80 percent of his salary, and he walks in, and he says,
22 "I'm going to retire." I cannot match --
23 I can't make a counter. One of the top guys in the
24 state, in my opinion, and I can't make a counter, because
25 how do you argue from that? Because he certainly could

1 work for a county next door and make the same salary he
2 was making for me, and then in a sense double-dip. Now
3 his salary goes almost double.
4 Getting back to even here locally, we're seeing
5 police chiefs that retire but are hired back on contract.
6 So we have police chiefs making well over $300,000 a
7 year. And that's in the paper. And the taxpayers are
8 kind of gulping, and they're saying, "So they retire at
9 55 and they come back and work for you as a consultant?"
10 There's a real disconnect there with the public.
11 The Sacramento Bee even came up with a study,
12 not only are they retiring, working somewhere else, but
13 they're also filing for unemployment insurance, and they
14 call it triple-dipping. So we're just seeing some
15 interesting issues that are surfacing that I think need
16 to be discussed in your efforts.
17 CHAIR PARSKY: Yes?
18 MR. PRINGLE: Well, if I could just jump back
19 in on that.
20 CHAIR PARSKY: Well, since your lunch has been
21 disturbed fully, you're allowed to come back.
22 MR. PRINGLE: Totally disturbed.
23 You know, I do like all this discussion about
24 local control issues, because I once was told that that
25 is a very conservative philosophy. And I look at a

1 conservative county.
2 Mr. Berardino, you like local control in the
3 negotiations of contract for your bargaining unit?
4 MR. BERARDINO: Only in every case except when
5 I'm bargaining with the mayor of the City of Anaheim.
6 MR. PRINGLE: But, I mean, do you have local
7 control?
8 MR. BERARDINO: Yes.
9 MR. PRINGLE: Have you bargained for your
10 bargaining unit a benefit of 3 at 50 upon retirement?
11 MR. BERARDINO: For --
12 MR. PRINGLE: Your bargaining unit.
13 MR. BERARDINO: We have one bargaining unit
14 that we bargained with for 3 at 50.
15 MR. PRINGLE: Why not all the rest?
16 MR. BERARDINO: Because -- these are always
17 loaded questions.
18 CHAIR PARSKY: We made him a little a grumpy,
19 and that's why he's asking you this question.
20 MR. BERARDINO: Because there are restrictions.
21 MR. PRINGLE: Right. And the restrictions are
22 placed locally?
23 MR. BERARDINO: No, they're not.
24 MR. PRINGLE: Therefore, there are restrictions
25 placed on what is available at the state level,

1 therefore, they're parameters in all negotiations in
2 terms of what is available as an option and what is
3 available to be discussed within the box of local
4 negotiations, thus the box of local control.
5 So there is not local control on all of the
6 things that you may wish to consider in your
7 negotiations; right?
8 MR. BERARDINO: That's correct.
9 MR. PRINGLE: And it's funny to me to hear a
10 couple of folks from Los Angeles County today mention the
11 desire to have greater local control; and then I heard a
12 number of Orange County retirees come forward to say,
13 "We wish there hadn't been the ability to have local
14 control and possibly a state level of protection on what
15 locals could do with retirement benefits for those who
16 have already retired"; right? I mean, I heard that.
17 So it's an interesting argument on local
18 control. And I know Mr. Kerr probably sees the same
19 thing. Not everything is available for you to have, from
20 your perspective or from your local government's
21 perspective in terms of having an available for local
22 control and local decisions; correct?
23 MR. KERR: Yes, I would agree with that.
24 And what the state has done to help us, we
25 negotiated the benefits locally, and the state has

1 offered legislation to the Assembly, to the Senate, and
2 through the Governor signing it, where we were able to
3 invest it in a larger pool and double our return. And I
4 thought it was a pretty good partnership between local
5 government, local employees, and the state government.
6 MR. PRINGLE: And when I was in the
7 Legislature, there had not been one -- I know Supervisor
8 Moorlach pointed out preemptions or presumptions of
9 cause, and the shifting of that presumption in terms of
10 how they relate to firefighters and public safety
11 employees. And those became legislative elements where
12 the presumption shifted as to -- where that lies in terms
13 of proving that cause of illness or injury. And those,
14 therefore, took away that local control, or that local
15 discussion. In fact, made a state directive, a state
16 mandate; and certainly the Legislature voted for that.
17 And the Governor signed those shift of presumptions; and,
18 thus, that is not an available issue for discussion for
19 local control as well. Is that right?
20 MR. KERR: Actually, administratively it is.
21 I wish it was that black and white and that easy. But
22 every firefighter who goes off on any type of job --
23 linked cancer or injury or dies in the line of duty or as
24 a result of injury or illness, his family, his spouse,
25 his folks have to fight for those benefits, whether it's

1 the federal public safety officer benefit, whether it's
2 the state workers' comp benefit, and then going through
3 the retirement system.
4 For all the folks that we've lost over the last
5 decade, there has not been one easy blueprint of how it
6 is done. And we had to set up our own 501(c)(3) to
7 help families not only bury firefighters, because when
8 they're killed in the line of duty, our employer didn't
9 pay for the burial, but also to help the widow and the
10 orphan to get through their mortgage for the next month
11 or two and to buy them clothes to attend their daddy's
12 funeral.
13 So a lot of those things that look really good
14 on paper and it was done with intent of the best of
15 intentions on both sides don't always play out in the
16 real world that easily and that cleanly.
17 MR. PRINGLE: But in that regard, there was a
18 legislative direction to change where those presumptions
19 lie?
20 MR. KERR: Yes, you are correct.
21 MR. PRINGLE: In a number of those cases.
22 Thus making it easier in terms of those debates
23 regardless of how difficult and challenging they may have
24 been.
25 MR. KERR: Right. Well, I just want to

1 cherry-pick what works for me.
2 MR. PRINGLE: And I guess that's my point. And
3 thank you for stating that.
4 MR. COTTINGHAM: Mr. Chairman?
5 CHAIR PARSKY: Two more quick questions.
6 That's all.
7 MR. COTTINGHAM: Actually, go back to Mr. Kerr,
8 because I guess I missed the point about the defined
9 contribution for the new employees.
10 MR. KERR: Yes, sir.
11 MR. COTTINGHAM: And I know you were a part of
12 a group that I was also a part of that we went through
13 the state arguing against the initiative that was coming
14 up at the time, to switch all retirements to defined
15 contributions.
16 How are you dealing with the death and
17 disability aspect for your firefighters that are going to
18 go into that?
19 MR. KERR: Say that again? I'm sorry.
20 MR. COTTINGHAM: Okay, when we fought against
21 defined contributions, specifically over public safety,
22 we saw that the largest flaw was death and disability.
23 MR. KERR: Understood.
24 MR. COTTINGHAM: And how are you dealing with
25 that in your new employees that go into this program?

1 MR. KERR: The new program only deals
2 specifically with retiree health care for new employees
3 only. Everything else stays the same.
4 MR. COTTINGHAM: Okay, I guess I missed that.
5 MR. KERR: My apologies.
6 MR. COTTINGHAM: With Mr. Moorlach and
7 Mr. Berardino, I think both of you are from a different
8 Orange County, because Mr. Moorlach paints a picture of
9 gloom and doom and what's happening, and you're
10 suggesting you need to go to a defined contribution also.
11 And then Mr. Berardino says everything is solid, it's
12 been reevaluated, it's coming back.
13 But when you talk -- I think when you talk
14 about the investments' footprint for defined contribution
15 as opposed to what is happening now with defined
16 benefits, I think that structure is going to be
17 different, because that money is going to be dispersed
18 throughout -- not into California, not held in deposit,
19 but it's going to go throughout the United States and the
20 different financial houses that these people invested in,
21 and they're going to decide the investments, not your
22 retirement or not CalPERS retirement board but those
23 different financial houses. I don't think you're going
24 to see that same investment return into California, into
25 California's infrastructure.

1 MR. MOORLACH: That could be true,
2 Mr. Cottingham. But one of the things that I try to
3 emphasize as a board member of the retirement system, is
4 that the retirement system should be in the retirement
5 business. So now you have OCEA and you have the
6 firefighters investing their retiree medical funds into
7 the retirement system. So you have one money manager
8 that's overseeing the whole portfolio, and you saw
9 Mr. Berardino's graph on the returns that have been
10 generated the last 14 and a half years, so this is a
11 success story.
12 And Mr. Kerr has said it several times,
13 legislation that the Governor signed to allow for us to
14 put our trust funds in OCERS was rather dramatic and a
15 good, positive step forward.
16 I think if we offer a defined contribution
17 plan, I would strongly encourage those employees that
18 don't feel they have the acumen to invest their own funds
19 and diversify their own portfolio, do their own asset
20 allocation, make their own repositioning decisions, they
21 could put it in the OCERS portfolio, and it's already a
22 diversified and managed, and it has representatives from
23 the employees and the retirees on that board to make sure
24 that the management is being done in an appropriate and
25 thoughtful way.

1 MR. COTTINGHAM: So your solution is that the
2 retirement board itself actually runs the DC plan?
3 MR. MOORLACH: That's what I would encourage,
4 yes.
5 MR. COTTINGHAM: Okay, because I also read a
6 report in the Washington Post within the last couple days
7 that said there's Boeing International paper, Lockheed
8 Martin, there's employee lawsuits over the excessive fees
9 charged by the carriers of their DC plans.
10 MR. MOORLACH: Well, you wouldn't have those
11 fees, if you had the monies inside your own retirement
12 system that was local or use CalPERS as well for those
13 municipalities that are not 37 Act counties.
14 MR. COTTINGHAM: Actually one final question,
15 again for Mr. Moorlach -- well, a comment.
16 When you said these benefits changed overnight,
17 it took 30 years -- the 2 percent formula came in, in
18 1968. It was almost 30 years before the 3 percent
19 formula, or the other formula changes came in. The
20 legislation was on the table for over a year, then things
21 were negotiated. So I think it was not an overnight
22 change that brought these things into play. And when you
23 talk about having open disclosed negotiations, would you
24 also advocate that our city councils and our board of
25 supervisors have an open and disclosed discussion of how

1 much funds -- what the funds are available for employee
2 raises and benefits? Because now that's done in closed
3 session.
4 MR. MOORLACH: Just to respond to the first
5 question, Mr. Cottingham, I apologize for being a little
6 abbreviated in my response, but I've had a lot of
7 dialogue with public safety officials and, you know,
8 trying to get this history. And so I didn't mean to
9 sound flippant.
10 As to the other comment about bargaining and
11 open, I believe that's fair game.
12 MR. COTTINGHAM: Okay.
13 CHAIR PARSKY: Last question, Connie?
14 MS. CONWAY: Thank you, Mr. Chairman. I didn't
15 want to leave Mr. Danner out. And this question will not
16 compare to anything else you just heard.
17 I wanted to make sure I understood you
18 correctly because I'm not familiar with your hybrid plan
19 or, you know, I'm just hearing about this today. And I
20 wrote a note to myself.
21 Did you tell me that over half of the employees
22 that could choose to implement the new plan did so? I
23 was just looking for a statistic there.
24 MR. DANNER: No, I'm sorry, I may have misled
25 you. Approximately half of our employees either chose

1 the defined contribution plan or were forced into it by
2 the negotiations.
3 MS. CONWAY: Okay, that does make a difference.
4 Thank you.
5 MR. DANNER: But, again, I want to emphasize,
6 we came up with this age-plus-years-of-service breakdown
7 to try to make a logical separation. And at the end of
8 the day, it probably didn't matter because the people
9 that benefit by the defined contribution were those less
10 than 50 years old, age plus years of service.
11 So it was an artificial thing that we
12 developed, with very few exceptions, probably five people
13 fell out of the boundary of what would have made a
14 different decision, had they been able to.
15 MS. CONWAY: Had they been able to? That's
16 good. Thank you. I'm intrigued by this. It's something
17 new that I haven't seen.
18 Thank you Mr. Chairman.
19 CHAIR PARSKY: One last question. Sorry. One
20 last question.
21 MR. HARD: One last question for Mr. Moorlach.
22 You said that there's this double-dipping and
23 people leaving and then retiring and then taking other
24 jobs. And I've been a public servant since 1975 and was
25 wondering what percent of the workforce does that?

1 Because I'm not very familiar with it in my experience.
2 I know it happens; but I just wondered, do you have, like
3 a percent of workers that do that?
4 MR. MOORLACH: You guys are playing
5 stump-the-band, and you're doing a good job. I do not
6 have a percentage.
7 MR. HARD: I'm presuming it would be extremely
8 small, but I don't know the number, either.
9 MR. MOORLACH: I don't know.
10 MR. HARD: Okay, thank you.
11 CHAIR PARSKY: Okay, well, I have totally
12 failed at monitoring this process, but since I'm only
13 about an hour and 45 minutes behind. However, I really
14 appreciate this panel. It was very important, very
15 important that the public hear the dialogue, very
16 important your contributions.
17 We'll take 30 minutes for lunch. And I'll see
18 if we can reorganize the rest of the day.
19 *(Midday recess taken from 1:23 p.m.*
20 *to 2:08 p.m.)*
21 CHAIR PARSKY: We're going to postpone until
22 our next meeting two items that are on this agenda. One
23 item that begins at 2:30, relating to Background and
24 Policy Principles for Public Employee Retirement
25 Benefits; and with one exception, the Issues Facing Local

1 Governments as They Move Forward, so that we're not here
2 until seven or eight o'clock tonight.
3 Ron Dole, we may want to ask to make a brief
4 presentation.
5 And we're going to move now along the lines of
6 the same agenda, but combine "Framing the Issue While
7 Recognizing Unfunded Liability is Important," and
8 "Implications of GASB 43 and 45 on Public Financing."
9 And we'll try to conduct this in about
10 45 minutes with questions for our panelists.
11 Michelle "Zerkowski"; is that correct?
12 MS. CZERKAWSKI: Close enough.
13 CHAIR PARSKY: Close enough?
14 Why don't you correct me then?
15 MS. CZERKAWSKI: It's "Churkowski."
16 CHAIR PARSKY: "Churkowski" -- Michelle
17 Czerkawski is going to make the first presentation.
18 MS. CZERKAWSKI: Thank you, Chairman Parsky.
19 I am very pleased to be here this afternoon.
20 And thank you, Chairman, and Members of the Commission
21 for inviting me to be here to speak about the role of the
22 GASB, as well as its accounting standards related to
23 post-employment benefits.
24 As the chairman mentioned, my name is Michelle
25 Czerkawski. I'm a project manager on the staff of the

1 Governmental Accounting Standards Board, which we refer
2 to as the "GASB."
3 Before I begin, I need to make our standard
4 disclaimer that my comments here today are my own, and do
5 not necessarily represent the official positions of the
6 GASB. That board reaches its decisions only after a very
7 formal and extensive public due process, similar to that
8 with which you all are very familiar.
9 Today I would like to focus my comments -- and
10 I had planned hopefully to take less than ten minutes of
11 your time to allow for adequate time for an exchange.
12 But I'd like to focus my comments really in three
13 principal areas, and I will touch on a fourth.
14 First, I'd like to talk a little bit about what
15 is the GASB, what is its role, what is its authority.
16 Second, I will identify the primarily relevant
17 GASB standards related to post-employment benefits.
18 Third, I'd like to focus most of my comments on
19 the philosophy or approach that underlies the GASB
20 standards in this area; and within the context of that
21 discussion, I will touch on a fourth area, which is the
22 summary of required information.
23 So, first, what is the GASB? The GASB is not,
24 as some assume, a federal organization. We are an
25 independent not-for-profit organization that establishes

1 accounting and reporting standards for state and local
2 governments in the United States.
3 Our board is comprised of seven members that
4 are generally representative of our very diverse
5 constituency groups. Those groups include preparers and
6 attesters with regard to government financial records,
7 users of those financial reports, as well as members of
8 the academic community.
9 The GASB's mission focuses on issuing standards
10 of accounting and financial reporting that are intended
11 to improve government financial reports based on the
12 needs of users of our financial statements.
13 The GASB is considered among governments and by
14 the accounting industry as a source of generally accepted
15 accounting principles. However, we have no enforcement
16 authority to require adherence to those principles.
17 Enforcement typically happens through an audit process,
18 whereby auditors offer or render opinions on the fairness
19 of financial presentation with regard to generally
20 accepted accounting principles.
21 In many states, there also are state laws that
22 require local governments to prepare GAAP-basis financial
23 reports.
24 Very importantly, our standards are applicable
25 only to general-purpose external financial reporting.

1 It is not our purview, and we do not wish it to be our
2 purview, to issue standards that relate to management
3 decisions, relate to accounting or reporting for
4 budgeting. And in the context of pensions and OPEB
5 benefits, it's very important to note, as you probably
6 all are aware, that we do not set standards that require
7 any particular approach or method to funding or financing
8 those benefits.
9 The board firmly believes that those issues are
10 appropriately left in the hands of those that have been
11 delegated that authority by the citizenry.
12 What are the pension and OPEB standards that
13 currently serve as the basis for accounting and
14 reporting? The pension standards, there are two of them.
15 Statements 25 and 27 were issued in 1994. They address
16 accounting for plans and employers, respectively.
17 Those statements have been in effect now for
18 just about ten years. And the board currently has a
19 research agenda on its project to examine the
20 effectiveness of those standards with respect to meeting
21 the needs of users of our financial statements. That's
22 purely a research project. It's part of our strategic
23 planning initiatives to automatically institute a review
24 of that nature after a standard has been effective for
25 ten years.

1 But I did want to mention that, as I understand
2 that project was mentioned briefly by commenters at your
3 last meeting. And if you would like any additional
4 information about that project and how it is proceeding,
5 we'd certainly be available to provide that to you.
6 The other two standards that form the basis
7 currently and as we move forward for post-employment
8 benefits are in the area of other post-employment
9 benefits, benefits other than pensions. Statements 43
10 and 45 were issued in 2004. Those, again, address plan
11 and employer reporting, respectively.
12 The OPEB standards, you'll note the ten-year
13 difference in terms of issuance date. OPEB was
14 originally part of the pensions project. But at the time
15 the board did not wish to risk delaying issuance of
16 standards on pensions, because it believed there may be
17 issues that were specific to other post-employment
18 benefits, specifically retiree health care and
19 specifically in the area of measurement of those
20 obligations, that caused them at that time to scope
21 retiree medical benefits out of the pensions project.
22 And so due to staffing considerations, et cetera, time
23 has its way of getting away from us, the board actively
24 picked up the OPEB project, again, in 1999. And that is
25 what ultimately resulted in the issuance of the final

1 statements in 2004.
2 As you're aware, we are now hearing a great
3 deal of talk about the ramifications of the information
4 that is being required to be presented by the OPEB
5 standards. The effective date for those standards is in
6 a three-tiered approach.
7 The largest governments based on revenues will
8 be required to begin implementing those in the fiscal
9 years that they are currently in, or will be entering
10 very shortly. Medium-sized and smaller governments have
11 an extra one and two years respectively to implement
12 those standards.
13 So what is essentially the foundation of the
14 GASB's requirements? Well, OPEB and pensions, the board
15 adopted the same general approach for both. And
16 underlying this was the board's understanding or
17 determination that, in their view, the transactions that
18 were happening really had the same underlying substance.
19 But, first, I'd like to mention that for planned
20 reporting -- and I'm only going to say this very brief
21 bit about that -- planned reporting focuses on
22 presentation of stewardship information. And when I talk
23 about planned reporting, I mean, reporting in the context
24 of the trust, the fund that's being used to administer
25 assets that have been set aside in the trust for purposes

1 of providing retiree pensions for OPEB.
2 With regard to employers, the board's approach
3 really is based on a concept that pensions and OPEB are
4 part of an exchange transaction between the employer and
5 the employees. They are part of the compensation that
6 employees receive for services provided to the
7 government. Some of that compensation is paid in the
8 period of active service, salaries and active employee
9 health care, for example. Pensions and OPEB are
10 different in that the compensation is not actually paid
11 out until the period following the active employment
12 period.
13 Nonetheless, the board views these as a
14 compensation for services, and believes that the cost, or
15 at least a part of that cost, should be recognized in
16 each period that the employee is rendering those services
17 to the government, so that the government can, in a most
18 transparent way, present to users of their financial
19 statements and financial information, information about
20 what the total cost of providing government services is.
21 To achieve this, the standards set up some
22 parameters. The information that's required to be
23 presented in the financial statements is based on
24 actuarially calculated amounts. The amounts that are
25 reflected in the actual financial statements of a

1 government -- the statement of assets, the statement of
2 changes in those assets -- are, first, based on an
3 expense amount. That expense amount, again actuarially
4 based, includes an amount to recognize on the cost of
5 benefits that are being earned by current employees in
6 the period, as well as a piece of the amounts that have
7 been accumulated over past service but have not yet been
8 brought onto the face of the financial statements.
9 It's important to understand that the total
10 amount that's required to be recognized as a liability,
11 an accounting liability, to be clear, is not the full
12 amount of the unfunded actuarial liability that is
13 calculated.
14 The liability that is reported is the
15 cumulative difference between the amounts that are
16 expensed and the amounts that are contributed to a plan,
17 a pension or OPEB plan. By "contributions," I mean,
18 transfer of cash to a trust or by direct payment of
19 benefits to retirees.
20 The information about the total actuarial
21 accrued liability, the unfunded portion, the relevant
22 assets, actuarial value of assets, and several ratios are
23 required to be presented in the financial reports but not
24 on the face of financial statements. That information is
25 included for the current year's information in notes to

1 the financial statements; and there's a multi-year
2 schedule of funding progress that's presented as required
3 supplementary information.
4 I'm not sure how close I am to using all my
5 time.
6 CHAIR PARSKY: That's okay.
7 MS. CZERKAWSKI: I would like to just mention
8 that for plans there are two financial statements.
9 There's a series of required note disclosures to provide
10 some context on to the activities of the trust, and then
11 there are supplementary schedules.
12 I've provided a great deal of information about
13 the actual accounting requirements here. It is at a high
14 level, but it's relatively detailed so I'm not going to
15 go into that.
16 I think I touched on the main points, being the
17 difference in the recognition requirements and what is
18 disclosed.
19 The boards believes, however, that it's very
20 important to have information about that total actuarial
21 accrued liability because it can be indicative -- it is
22 indicative of potential future cash-flow demands on the
23 government; and it's part of the big picture that the
24 financial statements are trying to convey.
25 And so with that, I will cease speaking.

1 And I'm not sure if you'd like to turn it over
2 to my colleagues first or --
3 CHAIR PARSKY: Yes, I think if we can do the
4 other presentation, then we'll come back and ask
5 questions to all three.
6 MS. CZERKAWSKI: Thank you.
7 CHAIR PARSKY: And the next topic is: The
8 implications of GASB 43 and 45 on Public Financing.
9 Parry Young. Is that right?
10 MR. YOUNG: That's right.
11 Good afternoon, Mr. Chairman and Members of the
12 Commission. I am Parry Young. I am a director in the
13 Public Finance Department at Standard & Poor's. And I'm
14 going to try to put a bond-rating perspective on the
15 issue of retiree benefits.
16 Some of the points in my presentation have been
17 already made today. I'll try to go quickly through
18 those. Some of them are still original. But luckily,
19 I'm the only person in the building that can tell you
20 what S & P thinks about retiree benefits.
21 CHAIR PARSKY: That may not hold true for other
22 subjects; but that one, it does.
23 MR. YOUNG: That's the one that I have a corner
24 on.
25 Just to emphasize where we're coming from, we

1 do these issue credit ratings, and it's an issue-specific
2 opinion of an obligor's creditworthiness with respect to
3 a specific financial obligation.
4 Here are some examples around California, with
5 the State's G.O. bonds at A-plus. Orange County lease
6 revenue bonds at A-plus. Los Angeles USD G.O.'s at AA-.
7 San Francisco G.O.'s at AA.
8 "A" category generally denotes a strong
9 capacity to pay principal and interest, and "AA" category
10 is very strong.
11 S & P was founded in 1860. We had been doing
12 ratings for about 80 years. I haven't been doing them
13 all of that time.
14 We have ratings on thousands and thousands of
15 municipalities throughout the United States and around
16 the world.
17 My remarks on government retiree benefits
18 reflect the credit ratings perspective and the expression
19 "likelihood of repayment -- capacity and willingness of
20 an obligor to meet its financial commitment."
21 A little preview. I'm going to talk about --
22 we pretty much hashed over what the issues are, and I'll
23 go through that quickly, and then the global impact of
24 retiree benefits and then a survey we recently did on
25 state pension funding and how California fits in there,

1 developments in the OPEB world on retiree health care,
2 and looking at some strategies for managing retiree
3 benefits and fiscal effect of these retirement benefit
4 pressures and what the credit implications might be.
5 Two good points, though, on pension
6 liabilities -- we're talking about the defined benefit
7 plans, which is most public plans in the United States --
8 the challenge there recently has been the plummeting
9 funding levels and the correlation of the increasing
10 contribution rates.
11 On OPEB, GASB 45 is focusing attention on the
12 funding of these obligations and the challenge there is
13 to manage them effectively under the new accounting
14 rules.
15 But we're not alone. It's a global issue,
16 driven by demographics, mainly the aging populations.
17 By 2050, the world's average age will be
18 38 years, ten years more than it was in 2005. Fourteen
19 countries, mainly in Europe, will have a median age of
20 50 or more. And the worldwide dependency ratio, that's
21 the population of 60 and more, will surge to 45 percent
22 by 2050, compared to only 19 percent in 2005.
23 The effect of this aging in various countries,
24 the age-related spending, unless they change policies,
25 these countries will suffer fiscal pressures on their

1 finances.
2 France, the age-related spending of the
3 percentage of GDP will go from 23 percent to 27 percent.
4 In Germany, 20 percent to 23. In the UK, 15 to
5 19 percent.
6 And right here in the United States, it's going
7 to increase even more dramatically. And this assumes no
8 changes in policy are made, that will go from almost
9 10 percent of GDP to almost 20 percent by 2050.
10 Recently, in February, we completed a survey of
11 state public funds as of 2000, and found the funded ratio
12 is about 82 percent in 2005. And that compares to over
13 100 percent on average in 2000.
14 Right here in California, the CalPERS PERF in
15 2005 was 87.3 percent funded and CalSTRS, the defined
16 benefit plan, almost 86 percent. And the unfunded
17 liabilities, almost $47 billion there. Now, but
18 California is a big state. On a per-capita basis, the
19 unfunded liability is about $1,300 per person, compared
20 to the average in the United States of about almost
21 $1,400.
22 On the OPEB front, Michelle has spoken
23 eloquently about this. And some of the points that I
24 would like to make, it's to emphasize that the new
25 reporting will recognize these costs and the periods when

1 they occur on an accrual basis. But it will also provide
2 information on the total liabilities and the extent to
3 which they're funded.
4 And then also information on future cash flows,
5 which in the rating business, we're very interested in,
6 in these issues.
7 Before GASB 45, it was on a pay-go basis, the
8 long-term liabilities had not been determined. We didn't
9 know what they were, and the projections of those future
10 costs were totally unknown.
11 Reporting the actuarial valuation would provide
12 a lot of good information. The annual required
13 contribution, the amount needed to fund this on an
14 accrual basis would be reported.
15 And then the net OBEP obligation, the
16 difference between those, between the ARC and what's
17 actually paid will be determined. And, of course, GASB
18 does not require the funding of these obligations, just a
19 reporting on them.
20 This is a hypothetical example of what these
21 payments might look like. The blue is the pay-go where
22 you can see the ARC going up, driven by aging and early
23 retirements and medical inflation. And then the red line
24 is the ARC, which is a little flatter curve. It might be
25 easier to manage.

1 Although in this case where the ARC is about
2 two times the initial pay-go, in reality, we're seeing
3 multiples of six, seven, eight, nine times.
4 Some selected OPEB liability cases here in the
5 state, 40 to 70 billion, an estimate. Los Angeles,
6 800 million. And they have funded more than half of
7 their liability. LA Unified, 10 billion, and
8 San Francisco, three to five billion.
9 There are basically only two ways to manage
10 an actuarially funded plan: You have to play with the
11 assets or the liabilities. And the balance is not easy,
12 especially when you're starting with no assets.
13 To increase assets, you can increase employer
14 contributions or introduce or increase employee
15 contributions.
16 Alter asset allocation strategy, although most
17 public funds are very professionally run and there's not
18 a lot of juice left there.
19 You can issue pension obligation bonds or OPEB
20 obligation bonds, and then insert assets in there right
21 away and get some investment income flowing.
22 Strategies to lower the liabilities might
23 include:
24 Reducing benefits if legally or politically
25 feasible.

1 Close plan to new members. Create a new tier
2 with lesser benefits. We've seen this a lot in the
3 pension area.
4 Cap total employer benefits -- that's both
5 pension and OPEB -- and convert defined benefit plan to
6 DC plan, as was mentioned this morning.
7 On the DB/DC conversion, a couple of important
8 things there. You would shift the investment risk from
9 the employer to the employee. And the final benefit is
10 no longer fixed or predictable.
11 In the private sector, since ERISA in 1974,
12 there's been a tremendous increase in DC plans and the
13 DB plans have gradually gone away.
14 The fiscal effect of the retiree benefit
15 pressures include the annual contribution rates that have
16 increased dramatically during this decade; but now they
17 look like they're going to moderate a little bit if
18 investment returns meet assumptions and liabilities are
19 kept in check.
20 If contribution rates remain high or increase,
21 they will add to fiscal stress.
22 On the OPEB front, in many cases where the
23 government has significant OPEB liability, there will be
24 OPEB cost pressures just based on the demographics of
25 medical inflation.

1 In places where the increases are material,
2 budgets may be strained.
3 As far as the credit implications of pensions,
4 we've incorporated these liabilities and payment streams
5 into our ratings for a long time, and excluding any
6 unusual event with an individual system, we'd expect
7 asset volatility to more or less affect pension plans
8 rather uniformly, as it did in the 2001-2002 investment
9 loss scenario.
10 Based on the experience over the last several
11 years, contribution rates could start to level off or
12 decline if funded ratios improve.
13 Should either poor investment returns or
14 liability growth cause contribution rates to again
15 increase rapidly, this development could become a rating
16 factor especially for weaker credits.
17 As far as the credit implications for OPEB,
18 unlike pension liabilities, this is new reporting
19 information that we did not know or anybody knew about
20 before about these liabilities and costs. We're seeing
21 a wide range in OPEB exposure as the actuarial valuations
22 become available from little to no liability, to huge
23 unfunded liabilities with large annual required
24 contributions relative to current pay-go's.
25 We expect most employees to be able to continue

1 to meet their ongoing OPEB cost requirements without
2 adverse effect on credit quality over the near term.
3 And that concludes my comments. Thank you.
4 CHAIR PARSKY: Thank you very much.
5 Dari Barzel.
6 MS. BARZEL: Thank you.
7 CHAIR PARSKY: Is that right?
8 MS. BARZEL: Can you hear me?
9 CHAIR PARSKY: Speak into the microphone and
10 you'll be fine.
11 MS. BARZEL: Okay, thank you.
12 CHAIR PARSKY: Is your green light on there?
13 MS. BARZEL: Much better. Thank you.
14 CHAIR PARSKY: You're welcome.
15 MS. BARZEL: Yes, I'm Dari Barzel. I'm with
16 Moody's. I'm also with a bond-rating agency. I thought
17 I would focus a little bit more on OPEBs themselves --
18 since that's the new gorilla in town -- and let you know
19 how we're looking at those.
20 I wanted to step back a little bit, though, and
21 let you know what a bond-rating agency does and how we do
22 what we do.
23 A bond-rating agency assigns rating to local
24 government bond issues. That's my job. I focus on local
25 governments in the state of California.

1 We are evaluating the issuer's ability and
2 willingness to pay.
3 One fact that is very important is that all of
4 our bond ratings are relative, meaning, that we're
5 comparing cities against other cities.
6 This is a very crowded slide, which basically
7 talks about the fact that we did an analysis of default
8 rates among local governments; and we determined, to
9 nobody's surprise, that default rates among local
10 governments and governments in general, is much lower
11 than that of corporate entities. Of course, governments
12 are able to pay, and governments are able to pay much
13 better than corporate borrowers are.
14 We could have just said, "Okay, well, then
15 everybody is AA or AAA and let's all go home." But that
16 was not of interest to the investors in the bonds.
17 Investors in the bonds wanted us to make a little bit
18 finer distinction among local government entities. So
19 from the get-go, it is assumed that an A-rated government
20 is going to be able to pay its obligations better than an
21 A-rated corporation. It's a completely different scale.
22 Having said that, what are our fundamental
23 rating factors? What do we look at in municipal
24 governments? We look at, we call them, the four factors:
25 The economy and tax base, finances, debt level and debt

1 structure, and management.
2 The OPEB liabilities do affect three out of
3 four of those factors. They're just one aspect of all of
4 those factors.
5 My presentation, which I've made in various
6 forms over time, has been designed primarily to address
7 the panic in the eyes of bond issuers who get very, very
8 concerned that the actuary is going to come back with a
9 big number and then we're going to downgrade them. And
10 that's not the situation, and I'm going to be explaining
11 why.
12 First of all, we do believe that OPEB
13 disclosure is a very good thing, in large part, because
14 it enables local governments to understand the magnitude
15 of the promises that they've made, it enables local
16 governments to decide how to address those promises, and
17 how to make decisions going forward. So everybody has a
18 much better understanding of where we stand right now and
19 how the future might look, absent any changes, and how to
20 make those kinds of changes.
21 We understand a large number of things about
22 the OPEB, that issuers just don't need to worry about.
23 We understand that typically in the past, governments
24 have provided fairly generous benefits. Governments have
25 not prefunded those benefits. Governments routinely have

1 operated on a Pay-Go basis, and that's been fine. We do
2 understand that the OPEB numbers result in a very large
3 present-value obligation. That's fine.
4 A typical OPEB exposure is already built into
5 the ratings, kind of by definition because, as I said,
6 all of the ratings are compared to each other. So a
7 standard obligation, the median obligation is already
8 in there. We're going to look and see over time if your
9 obligation turns out to be much lower than somebody
10 else's, you're doing great. Much higher than somebody
11 else's, you might have a problem. But the median, your
12 average entity with your average obligation, it's already
13 in the rating.
14 The other thing is that even if the OPEB
15 obligation is converted into debt tomorrow, if you take
16 the $3 million or the $30 million or the $300 million and
17 turn it into debt, you pay it off $3 million a year,
18 chances are you can afford the $3 million. And an OPEB
19 obligation, like the pension obligation, like a pension
20 obligation bond or like any other debt is an annual
21 obligation that you pay over time. And we can look at it
22 that way.
23 And the back-of-the-envelope calculation, we
24 have looked at it that way. It's not formal, but that is
25 how we're looking at it right now.

1 The most important thing right now is, what is
2 the government's response to the number that they're
3 being presented with? How are they evaluating what the
4 current situation is and what are they going to be doing
5 about it?
6 Right now, it isn't very, very early. The
7 standards haven't been implemented yet, never mind
8 finding consistency across governments and consistency of
9 responses. Right now, what we're mostly looking at is,
10 where is a particular government on the learning curve?
11 And the learning curve starts with, "What's OPEB?" Which
12 somebody had asked me recently. And it goes all the way
13 through, "Well, we're not quite ready to do an actuarial
14 study but we're going to," or, "We've done one, and we
15 know we have to do something about it, but we don't know
16 what," or "We looked at all of our various alternatives,
17 and these are the things we're going to implement" or
18 "we've begun implementing."
19 I mean, that seems to be the standard -- you
20 know, where you might be on the learning curve. And
21 different government entities are at very different
22 places along there.
23 In the future, likely ways in which we might
24 focus on the OPEB liability, to decide whether or not it
25 is a problem, we might normalize it against payroll.

1 We might normalize it against budget, against revenues.
2 We might normalize it against the tax base. Again, all
3 in order to provide us a basis for comparing governments
4 against each other, which is what we do. We might look
5 at OPEB costs as a percentage of the budget now and going
6 forward, assuming certain assumptions are held steady
7 over the course of time.
8 The assumptions themselves are going to be very
9 important. And the actions that a local government is
10 taking in order to control their costs, those are going
11 to be very important to us as well, whether the
12 government is looking at changing benefit levels, whether
13 it's considered that as an option, whether it thinks
14 that's a good idea, whether it has the assets to prefund
15 and is choosing to prefund. We don't have any preferred
16 alternatives. We just want to understand that the local
17 government is thinking about it, is addressing the
18 problem, and has come up with what is a rational solution
19 from its own perspective.
20 Over the long-term, OPEB liabilities may lead
21 to rating changes, as I said earlier. Over time, it will
22 be determined what is a normal, what is a standard; and
23 over time, it will become clearer if you're doing better,
24 if you're doing worse than average which could, in the
25 end, lead to a rating change.

1 The final thoughts. In the short-term, there
2 is not going to be a need to fund the OPEB liability in
3 order to maintain a rating. That may change over the
4 long-term, but it's not going to happen immediately.
5 And people do ask us about OPEB bonds. And I
6 do have to say that OPEB bonds, it's funny for me to say
7 that in and of themselves they're not a credit negative.
8 It's funny for a bond agency not to like debt. But as
9 a matter of fact, you know, the more debt you have, the
10 more of a credit risk you may be perceived to be. So
11 we say, "Okay, an OPEB bond in and of itself is not a
12 problem, as long as it's part of a very carefully crafted
13 solution, as long as it's clear that you understand what
14 your liability is, and it seems to make sense as part of
15 your overall plan.
16 Whenever bonds are issued, an issuance of a
17 bond results in a lack of flexibility because all of a
18 sudden you now have fixed payments to be made over the
19 next 30 years as opposed to without the bonds, there may
20 be more flexibility. If you've evaluated that, you
21 understand what you're giving up in order to get what
22 you're getting. Bonds can be okay with us.
23 That's it.
24 CHAIR PARSKY: Thank you all very much.
25 This is somewhat of a complicated subject, but

1 why don't we open up to questions from anyone on the --
2 yes, Curt?
3 MR. PRINGLE: I would just like to ask
4 Mr. Young after hearing the Moody's presentation or the
5 representative from Moody's. Is there a distinction that
6 S & P has made in terms of -- would you say there's a
7 different view on that liability in consideration in your
8 ratings? I mean, are there nuances that the rating
9 agencies are considering between the three agencies?
10 MR. YOUNG: I think you have to decide that.
11 I'm not really familiar with Moody's criteria on this.
12 MR. PRINGLE: Therefore, in terms of your
13 criteria, what would be unique considerations that you
14 would put into place in terms of making those credit
15 evaluations?
16 MR. YOUNG: What would be unique?
17 MR. PRINGLE: Or what are yours, what do you
18 consider within S & P when you provide for that rating?
19 Do you look at anything any different than what you just
20 heard?
21 MR. YOUNG: I wouldn't say a whole lot
22 different, no.
23 MR. PRINGLE: Is there a challenge at this
24 moment in time to be able to have this agency-by-agency
25 comparison in order to be able to look at that, and,

1 thus, some of those challenges may be addressed with
2 greater reporting that may move forward with the GASB
3 standards?
4 MR. YOUNG: Well, I think as more information
5 becomes available, then I think a lot of these questions
6 will be able to be fleshed out.
7 MR. PRINGLE: All right. You're really
8 tight-lipped.
9 Thanks.
10 CHAIR PARSKY: We'll try to loosen him up a
11 little.
12 Teresa?
13 DR. GHILARDUCCI: Yes, exactly on that, maybe
14 to GASB, is there an actuarial --
15 AUDIENCE: We can't hear.
16 DR. GHILARDUCCI: Is there an actuarial method
17 that you prefer? Projected unit cost --
18 MS. CZERKAWSKI: I'm glad you asked the
19 question. I was chomping at the bit to jump in as Parry
20 was speaking.
21 Strict comparability among governments will not
22 be as easy as some would hope. The GASB's parameters
23 that are established in both the pension standards and
24 carried forward in the OPEB standards are very flexible
25 in terms of the methods and assumptions that may be used.

1 The parameters rely very heavily on actuarial
2 standards of practice, and that's primarily because of
3 the complexity of the measurement model.
4 They do establish some guidelines within which
5 methods and assumptions must be chosen. But, for
6 example, the standards do allow a choice of six actuarial
7 cost methods.
8 In the pensions environment, where most pension
9 plans were funding -- advance funding at the time the
10 standards were issued, some may think that makes more
11 sense than the OPEB environment. But, you know, it's yet
12 to be seen what's going to materialize in that area.
13 Oftentimes, the standards have been referred to
14 as somewhat funding-friendly because of that flexibility.
15 The board really relied very heavily on the actuarial
16 standards of practice, examined the methodologies that
17 are acceptable under those standards, and did weed some
18 out in terms of, for example, cost methods the Board did
19 not feel that they were consistent with the concepts of
20 accrual basis accounting.
21 For the others, they saw no reason to deviate
22 from what's considered an acceptable actuarial cost
23 method for funding purposes, given that it is consistent
24 with our concepts.
25 And so they thought that there was some

1 usefulness in information, since the information in
2 financial reports as presented on a consistent basis with
3 that which the government is being used for management
4 purposes.
5 DR. GHILARDUCCI: So you don't take a more
6 activist view? You don't have a best-practice list or a
7 preferred methods or even a survey of what is being done?
8 MS. CZERKAWSKI: We do not establish best
9 practices in this area. As part of our pension research
10 project, we currently are obtaining information about
11 what currently is being done in public pension practice.
12 DR. GHILARDUCCI: Not in retiree health?
13 MS. CZERKAWSKI: Not in retiree health.
14 Primarily the information is not out there because it's
15 been done on a pay-as-you-go basis for the most part.
16 Oftentimes when governments and government
17 officials -- this is a very complicated subject, as we
18 all have come to understand, and oftentimes, particularly
19 if you're not advance-funding and may not be planning to
20 advance-fund perhaps for quite a long time, and that's
21 perhaps a perfectly acceptable funding methodology, then
22 you may very well for financial-reporting purposes select
23 the same method that you use for pensions because you
24 have some base knowledge about how that method functions.
25 DR. GHILARDUCCI: This is also sort of a

1 blue-sky question, but half of public employees in
2 California don't have access, or maybe it could be up to
3 half don't have access to Medicare.
4 In your experience, just looking at other
5 states, how much does that matter in terms of -- just
6 your sense of it -- how much of a liability California is
7 carrying versus other states that have full Medicare
8 coverage?
9 MS. CZERKAWSKI: Is that directed at me or -- I
10 really can't --
11 DR. GHILARDUCCI: I'm looking at all of you
12 guys.
13 MS. CZERKAWSKI: I'm hoping it's directed at
14 someone else. I really don't have any data to support a
15 conclusion on that.
16 DR. GHILARDUCCI: Perhaps your colleagues have.
17 MR. YOUNG: There are other states that are in
18 a similar position.
19 DR. GHILARDUCCI: Massachusetts and Texas.
20 MR. YOUNG: And when they were talking about
21 making all states go onto Social Security, as they would
22 periodically do, that would have been -- could have been
23 a serious credit issue with all the increased
24 contributions to Social Security. But as far as your
25 OPEB thing, it's a little difficult to measure yet; and

1 we don't have the numbers yet.
2 DR. GHILARDUCCI: Yes.
3 Do you have an opinion on that?
4 MS. BARZEL: I could only agree that it's early
5 yet.
6 DR. GHILARDUCCI: Okay. But you also agree
7 that when we were talking about universal coverage and
8 Social Security, that looked like a liability issue with
9 the states and a credit issue for states? It didn't
10 help.
11 MR. YOUNG: Mandatory Social Security, yes.
12 CHAIR PARSKY: Yes?
13 MR. COTTINGHAM: So as I understand it then,
14 there's no real set formula or best practices for
15 determining your OPEB liability?
16 MS. BARZEL: I would not put it in exactly that
17 way.
18 What I would say is that we rely on actuarial
19 standards of practice. The actuaries do have established
20 standards through due-process procedures, et cetera, that
21 do set some parameters around the measurement process.
22 Our standards, in addition, put another layer
23 of kind of guidelines and parameters on top of that.
24 MR. COTTINGHAM: But could two cities or two
25 entities with the same financial or fiduciary issues come

1 up with different liabilities?
2 MS. CZERKAWSKI: I believe that is possible.
3 The actuaries -- and this is the best kind of
4 deferral -- but there are some actuaries on the panel
5 following ours, that are scheduled to speak, and they may
6 be able to put some better ideas in terms of the
7 magnitude of those differences. But, yes.
8 MR. COTTINGHAM: And with the liability, when
9 it comes to bonding -- because this is where it seems to
10 be the biggest issue. I mean, since this is a nationwide
11 issue and every entity, municipality wants to have a good
12 credit rating, wants to make loans; bonding houses,
13 financial houses want to issue credit, what is going
14 to -- maybe you can't answer this -- but what is the
15 determining factor that's going to tell you when -- you
16 know, obviously, if an entity does nothing, they're not
17 going to fare well when they're trying to get a bond or
18 get their credit rating. So what is the real determining
19 factor in bonding or in getting credit that's going to
20 make one entity stand out over another that they're not
21 actually addressing the issue as well as they should or
22 that they have actuarially or in their accounting have
23 not reported it correctly?
24 MS. BARZEL: I was going to answer the question
25 not from the actuarial perspective but from the

1 managerial perspective. Because at this point in the
2 redevelopment of the OPEB process, I think that's where
3 we are.
4 It's not really a matter of -- as long as they
5 got an actuarial report that is compliant with actuarial
6 standards, and as long as the assumptions within that
7 report appear somewhat reasonable on, you know, whatever
8 basis they choose to present those, again, we don't yet
9 have nationwide standards to determine what's reasonable
10 and what isn't, so they must have some experience that
11 they can throw at the report and come up with some kind
12 of valuation.
13 The most important thing is the fact that
14 management is willing to understand the number when it
15 comes back, what that number represents, whether or not
16 they want to fund that number, at what level, for what
17 reason, and how they're going to go about addressing the
18 situation.
19 There are local governments that have an
20 enormous number -- you know, OPEB number that have not
21 faced the question of, "So what do I do now?" I mean,
22 they're in a position that's very, very difficult. If
23 they can't renegotiate the benefits, that's difficult.
24 If they don't have the assets to put against the
25 liability, that's difficult.

1 At this point, I'm not going to lower their
2 bond rating as a result of that fact. I'm going to note
3 that. I'm going to actually write a little paragraph in
4 the report saying, "It looks like they're going to have a
5 problem." Over time, over the course of few years, as
6 other people are finding solutions, if these guys still
7 don't have a solution, then it's going to start making a
8 difference.
9 MR. COTTINGHAM: Okay.
10 MR. YOUNG: I think as far as the actuarial
11 methods, I think we'll have to follow the pattern of the
12 pension arena to a large extent, at least initially,
13 where most public pension funds use entry-age normal and
14 some use other methods, including the aggregate which
15 doesn't report an unfunded liability. But as long as
16 they use a consistent actuarial method and have good
17 reasons for using that method, we rely on them for their
18 consistency.
19 And as far as where the government has to
20 get -- I think you were asking, where is the point where
21 we lower the rating; is that basically what you're
22 getting at?
23 MR. COTTINGHAM: Yes.
24 MR. YOUNG: But we're not going to be in a
25 position to set public policy or tell a government

1 what percent of their costs should be spent on benefits
2 for either pensions or OPEB. They have to manage that
3 within their own policies.
4 But where it comes to the point where it crowds
5 out their ability to pay debt service, that's where it's
6 going to have an effect on credit.
7 And I couldn't possibly tell you where that is
8 right now.
9 MR. COTTINGHAM: It seems like each one would
10 be different, I guess.
11 MR. YOUNG: I'm sorry?
12 MR. COTTINGHAM: Each entity, I guess at that
13 level it would be different.
14 MR. YOUNG: Exactly.
15 MR. COTTINGHAM: Okay, thank you.
16 CHAIR PARSKY: Dave?
17 MR. LOW: On the pension unfunded liability
18 issue, we've seen a variety of pension funds with various
19 unfunded liabilities ranging from 69 to over 100 percent.
20 And I often hear descriptions of the same unfunded
21 liability on one side as, you know, 90 percent unfunded
22 liability is this huge unfunded liability, it's a ticking
23 time bomb; and on the other side say it's a fiscally
24 sound system, 90 percent is good.
25 So give me a perspective on how you evaluate

1 the unfunded liabilities of these pension funds that are
2 in that neighborhood.
3 MS. BARZEL: Are you looking at me?
4 MR. LOW: Any of you.
5 MS. BARZEL: I'm happy to do that.
6 Again, what we tend to look at is, over time,
7 a history over time. We can understand it at any
8 particular moment. If the stock market just crashed, all
9 of a sudden your funding level will have just crashed
10 as well. So there isn't a specific number, it's not
11 going to be 60 percent, it's not going to be 70 percent.
12 It depends on the moment where they are as far as the
13 market situation.
14 Also, it matters over time, over, you know, the
15 course of five, ten, 15, 20, 30 years. If they have been
16 consistently underfunded for a very extended period of
17 time, then, obviously, that indicates that there has been
18 a problem.
19 We expect there to be normal variations.
20 You're underfunded sometimes, you're overfunded
21 sometimes. That's pretty much how it goes.
22 Another very important factor, though, will be
23 whether the local government has been making its
24 actuarially required contributions along the way. I
25 mean, that's a more important factor in the long run.

1 MR. LOW: So let me just get to a more specific
2 case. Let's choose CalPERS as an example. They, before
3 the stock market crashed, they were at 130 percent. They
4 dropped down to about 87 -- you know, 85 percent
5 afterwards. They've recovered to a +90 percent now.
6 How would you rate their system?
7 MS. BARZEL: I wouldn't rate CalPERS' system.
8 I know what I can tell you is that we are very
9 comfortable with the pension situation of participants in
10 the PERS system. And part of the reason is that it's our
11 understanding that PERS does impose discipline. Anybody
12 who participates in the PERS plan is going to be making
13 payments and is going to be making payments that are
14 consistent with a fully funded system over a long period
15 of time.
16 MR. LOW: And on the GASB unfunded liability,
17 it seems to me there's a lot of factors into continuing
18 pay-go on the short-term basis over the long-term, many
19 of which are, for example, lack of enough vehicles, I
20 know that there's discussion right now about whether
21 CalPERS would be available to non-PEHMCA agencies, you
22 know, their bargaining process, the fact that we have a
23 three-year phase-in and a lot of people haven't even done
24 the actuarial study. So it would seem to me that on the
25 short-term, there wouldn't be dramatic changes.

1 What is the sort of timeline you're looking at
2 as to -- do you have a ballpark on when you might be able
3 to start making a more comparative look at agencies?
4 MR. YOUNG: Well, I think that reporting is
5 only due for most large governments on June 30th, 2008,
6 it's going to take a while before this information starts
7 to come out. And I think it's going to vary.
8 I mean, the political process and the
9 legislative process varies from government to government.
10 So we don't have any real deadline. We want a plan and
11 progress and moving towards that plan.
12 And getting back to your earlier question about
13 the funding levels, we also look at what is happening
14 with the contribution rates that came down all through
15 the nineties and even through 2002, and then spiked up
16 after the investment losses in 2001 and 2002. We look at
17 how the government is managing that contribution rate
18 volatility. So that's another aspect.
19 Rather, the unfunded liability is a number out
20 there. But where the rubber meets the road is what
21 contribution rates are being made today and over the next
22 several years.
23 MR. LOW: Right. So getting back to the GASB,
24 would it be fair to say that -- because I think a lot of
25 agencies are -- when the number comes out, the tendency

1 for some is to press the panic button because the number
2 is big.
3 So would it be fair to say that there is no
4 reason to press the panic button, that there is some
5 time, that they have a reasonable period of time to
6 evaluate it and formulate decisions on a sort of rational
7 basis as opposed to rushing in to taking immediate
8 action?
9 MS. BARZEL: From my perspective, I would say
10 absolutely as long as they are addressing the question.
11 Like I said, anybody who at this point is sort
12 of saying, "What's OPEB," or "Well, I think we're going
13 to have a study soon," or "We've had a study, but we're
14 going to wait until our next study," that's not facing
15 the issue head-on.
16 On the other hand, as long as somebody is
17 taking steps towards addressing their issues, but that it
18 might take a year or two or three to come to a nice,
19 comfortable, steady state, that's something we can
20 completely understand.
21 MR. LOW: Thank you.
22 MR. YOUNG: And I think I can agree with that.
23 CHAIR PARSKY: John?
24 MR. COGAN: Thanks, Gerry.
25 Thank you all very much. It's very

1 informative.
2 And thank you, GASB. You've done a wonderful
3 public service with this circular. I think it's going to
4 be a real wake-up call for local governments around the
5 United States.
6 I wish S & P had done something, and I wish
7 Moody's had done something; but we are where we are.
8 I want to go back to the measurement question.
9 We had established that GASB allows the localities to
10 have broad latitude in choosing their assumptions,
11 choosing what discount rate they use, choosing the
12 assumed level of health-care cost growth. And one of the
13 issues that's going to come before the Commission is, do
14 we stay with where GASB is, or do we issue a more
15 prescriptive set of standards that localities should
16 follow in measuring their own unfunded liability?
17 So you can't answer that question for us. But
18 maybe you could inform us a little bit as to why you
19 stopped where you did. Why didn't you go further and try
20 to be more prescriptive?
21 The same thing with the other panelists. Why
22 wouldn't you be more prescriptive? Is it politics or is
23 it a lack of substantive knowledge about health-care cost
24 growth or what the right discount rate is?
25 So Michelle, do you want to start?

1 MS. CZERKAWSKI: Yes. I mean, first of all, I
2 think that the Board's standards couldn't be that
3 specific because it does vary so much, depending on types
4 of benefits that are provided, et cetera.
5 Just somewhat as an aside, but I believe it's
6 relevant, the actuarial profession has been dealing with
7 measurement issues related to retiree health-care
8 benefits for a long time, much longer than the GASB has
9 even been discussing OPEB issues, and that's a pretty
10 long time.
11 With regard to methods -- for example,
12 actuarial cost methods -- the board decided on the OPEB
13 side, it did really consider whether, given the state of
14 advanced funding on an actuarial basis -- or the lack of
15 it, I should say -- whether it should restrict the
16 options for financial reporting on the OPEB side. It
17 decided instead that consistency with pension reporting,
18 in essence, would kind of carry the day in that regard.
19 Again, relying very heavily on actuarial standards of
20 practice.
21 The other example that you gave was selection
22 of a discount rate. I'm not going to imply that we have
23 anything set in black and white to guide that assumption.
24 Actuarial standards of practice do guide that somewhat.
25 The board does set some parameters around that. It is

1 supposed to be selected on the basis of the expected rate
2 of return, long-term, on the assets that are going to be
3 used to fund the benefit, finance the benefits.
4 Now, that's a pretty broad range, particularly
5 given the mix of assets that may be used.
6 If you're currently on a pay-as-you-go basis,
7 that's the rate of return on government's general
8 investments, which typically is very small. And,
9 therefore, you're going to have a much larger actuarial
10 accrued liability in that circumstance.
11 If you start to set funds aside and fund on an
12 actuarial basis, then you get to use a discount rate
13 that's something blended. If it's not fully funded in
14 accordance with the funding -- you know, funding policy
15 does not anticipate full actuarial funding, then it's a
16 blended rate. So I'm not going to sit here and say that
17 we narrow it much. We do narrow it some. But, yes,
18 there is the potential for great flexibility in those.
19 And the board just could not find reasons at this point
20 in time to narrow it.
21 Obviously, the state of affairs is something
22 that the board will keep an eye on. Given the ten-year
23 time frame in terms of the standard review, it's going
24 to be quite a while given that the final governments
25 won't be implementing until sometime in 2010 for the

1 smallest governments, but it is something that staff will
2 continue to monitor.
3 MR. YOUNG: But there are some checks in
4 reasonableness on the discount rate assumption and
5 medical inflation assumptions.
6 We ask questions all the time from pension
7 funds: Why, are you assuming a 9 and a half percent
8 return and everybody else is at 78 percent? You know,
9 show me. So there's that kind of thing.
10 And also on the medical inflation, if you're
11 assuming 3 percent, we're going to ask you why, what's
12 going on there? And where do you live? There are some
13 checks.
14 MS. CZERKAWSKI: If I could make one extra
15 point, I think it's very important to note that the
16 standards do require disclosure of the actuarial methods
17 and assumptions so that, now, granted it does require
18 some pretty specialized knowledge about how these things
19 are measured; but you could, armed with those and perhaps
20 some experts or people who have some familiarity in the
21 area, start to question some of the numbers.
22 The board firmly believes, however, that the
23 numbers that are derived with the accompanying
24 no-disclosures are better than no numbers at all.
25 MR. COGAN: Right.

1 CHAIR PARSKY: Dari, do you have anything to
2 add?
3 MS. BARZEL: Not particularly. The only thing
4 I would say is that I think were we to describe
5 parameters that would be coming awfully close to setting
6 public policy, which is something we very much would like
7 not to do, we prefer to analyze and review.
8 MR. COGAN: Thank you.
9 MR. BARGER: Parry, you had a chart in here
10 that shows a hypothetical graph of pay-as-you-go versus
11 the ARC.
12 And the question I had on this was, what are
13 the implications of staying on the pay-as-you-go line, to
14 what that ARC line looks like, and when the lines cross
15 and then sort of come back?
16 MR. YOUNG: I don't know where the line was,
17 but the pay-as-you-go scenario, the do-nothing scenario
18 is simply trying to illustrate, GASB 45 did not invent
19 OPEB. It's been around for a long time, and will be.
20 This just shows what the effects of medical inflation and
21 demographics are hypothetically on a very fast ascending
22 line. And the ARC is on an accrual basis, how to fund
23 that liability.
24 That, I just made up in my Poor's work -- you
25 saw the Poor's PowerPoint work, but I did that all

1 myself.
2 MR. BARGER: My question sort of relates to
3 sort of a you-pay-now or you-pay-later sort of thing.
4 And what does it cost you in a sense to say, "I'm going
5 to stay on the pay-as-you-go line" to that future ARC,
6 which obviously the longer you wait, the higher it goes?
7 MR. YOUNG: Yes, if you stay on it -- I mean,
8 if OPEB is 1 percent of your budget today and in seven
9 years it's 3 or 4 percent, and in 12 years it's
10 12 percent, you know, there are going to be a lot of
11 people asking questions as to how you can manage that.
12 That's all that graph was really meant to show. And
13 that the ARC can actually bring down -- can arrest that
14 Mt. Everest slope.
15 MR. BARGER: Is there a presumption over what
16 period of time either rating agencies or GASB is looking
17 to sort of have the issue resolved, if the issue is
18 resolved in the sense that the ideal is that it's funded?
19 Is it something that's supposed to happen in 30 years,
20 ever, or --
21 MR. YOUNG: Well, it's 30-year amortization
22 under GASB. But as far as the resolution, from our
23 perspective, we don't really have any time horizon.
24 MS. BARZEL: I was just going to add that I
25 don't think that "resolution" is exactly the right word

1 because it's not something that is there and is going to
2 go away, it will be done with. It will become a normal
3 part of doing business, the same way as pension funding
4 is. It might become more normalized, people might
5 understand it better, might get it to a size that they're
6 comfortable with and be able to budget for the future
7 better; but I think that there will always be OPEB in the
8 same ways there will always be pensions.
9 CHAIR PARSKY: Yes, Lee?
10 MR. LIPPS: Ms. Czerkawski, does GASB 45
11 recommend the frequency with which a public agency should
12 have an actuarial study done?
13 MS. CZERKAWSKI: Yes, it does. In fact, it
14 sets some requirements for that, just as the pension
15 standards did.
16 The board requires actuarial valuations or
17 measurements to be done for OPEB plans at a minimum of
18 every two years for the largest plans, and a minimum of
19 every three years for smaller plans. And that's based on
20 size of plan membership.
21 There is, in addition to the requirement for
22 measurements -- most plans will be required to have an
23 actuarial valuation.
24 For the very, very smallest of plans -- those
25 are fewer than 100 plan members -- the Board attempted to

1 try to provide some supportive alternative measurement
2 methodology, I think is what it's finally been termed,
3 that allows for the simplification of some methods and
4 assumptions involved in the process of projection,
5 discounting, and allocating those costs over periods,
6 so that potentially those measurements could be made
7 without the involvement of an actuary.
8 I would caution that if a government does
9 choose to go this route, it does require some in-house
10 expertise or an ability and willingness to sit down and
11 learn a considerable amount about what things might need
12 to be considered in terms of a measurement.
13 It also may incur some additional audit
14 expense, because the audit community may not be able to
15 rely on the work of a specialist in that case.
16 MR. LIPPS: And then as Mr. Low referenced,
17 part of the panic sets in because we get these actuarial
18 studies and they give us one big number, and that's the
19 number that's reported in the note disclosure.
20 Is there anything that precludes an agency
21 from, as part of the note disclosure, sort of showing the
22 math behind where that -- in a simplified manner -- the
23 math behind which that number is finally totaled up, so
24 that it can be kind of compared on an ongoing basis with
25 what actually then happens in a particular year?

1 MS. CZERKAWSKI: I'm not aware of any
2 restrictions on what is presented. Governments certainly
3 can include anything in note disclosures that they
4 choose, as long as they do not contradict information
5 prepared on a GAAP basis.
6 We set standards for minimum disclosure
7 requirements, so any additional explanatory information,
8 as long as your auditor agrees to sign off on that
9 information and can attest to it, may be included.
10 There is additional information, again, in
11 supplementary schedules about over time. In planned
12 financial statements, there's also requirements to
13 disclose comparisons of expense and amounts contributed,
14 and a similar type of disclosure in employer statements.
15 You can see over time, based -- comparing the actuarial
16 calculations from a year-by-year perspective to what is
17 actually being contributed. And we also require
18 disclosures about funding policy, what's been done in
19 accordance with the policy, a description of the
20 benefits, a description of who has the authority, to
21 make changes to those benefits, et cetera.
22 So there is a lot of information that's
23 required. But any additional information that the
24 government believes would be informative to the user of
25 the statements, as long as it's not contradictory,

1 certainly wouldn't be prohibited.
2 MR. LIPPS: And finally, Ms. Barzel and
3 Mr. Young, how many years of data do you think you would
4 need to have in order to develop reliable baseline
5 measurements for purposes of comparability between
6 similar types of agencies?
7 MS. BARZEL: I think I would start by saying,
8 again, it's not just the number; it's how people are
9 addressing the situation.
10 If the entire local government and state
11 government community is in as much chaos three years from
12 now as they are now, then we're still not going to be
13 ready to compare anything. So it's not just the numbers;
14 it's where people are in addressing the situation.
15 Having said that, I mean, a minimum standard is
16 three to five years of information just to get a trend.
17 MR. LIPPS: So if you're going to use as a
18 baseline, for example, the size of the debt compared
19 to -- or that particular year's contradiction compared
20 to, as a percentage of that year's revenues, you probably
21 need, in order to develop some reliable comparability for
22 comparison purposes, about three to five years?
23 MS. BARZEL: I would say that. A minimum of
24 three years, certainly.
25 MR. YOUNG: I would agree to that.

1 CHAIR PARSKY: Bob?
2 MR. WALTON: Thank you.
3 One thing that I think needs somewhat
4 clarification. When we talk about OPEB, the benefits --
5 and we use the term "benefits" quite a bit -- I think a
6 lot of members, retirees, if you would, their concept of
7 benefits is what the plan provisions are. And we're not
8 really talking about the plan provisions, necessarily;
9 it's the employer's obligation to pay for those benefits,
10 which can vary dramatically from a percent, fully
11 100 percent, or to a flat dollar amount.
12 So inflation for the employer's cost is what
13 that employer's history is, not necessarily that overall
14 cost of health care. That's my understanding, at least.
15 But my question goes more from the standpoint
16 of the difference between pensions and health benefits as
17 it relates to OPEB.
18 In law, there's long-standing vested rights to
19 a pension plan. You know exactly what it's going to be
20 within certain parameters. In health, you don't have the
21 same laws and history of court cases that document what a
22 person's vested right is. And, unfortunately, we see
23 many employers trying to address OPEB by simply changing
24 the plan provisions, by dramatically increasing co-pays
25 or the share that the retiree pays.

1 Did GASB consider the difference in the state
2 of the law as it relates to vested rights for OPEB
3 benefits as it did to retiree benefits, retirement
4 benefits?
5 MS. CZERKAWSKI: Yes, it did. In fact, it
6 spent a considerable amount of time talking about whether
7 these standards should be based on essentially what is a
8 legal liability as opposed to what perhaps might be
9 viewed as an accounting liability.
10 The board chose to focus on the substance of
11 the arrangement that the employer is providing; and by
12 its actions, presumably is intending to continue to
13 provide.
14 The fact that laws exist -- and these exist
15 just about everywhere -- that says that retiree
16 health-care benefits can be changed.
17 The board took that very seriously. And as I
18 said, it did spend a considerable amount of time on that.
19 But when it came right down to it, the board really
20 believed that what's important here is to be reporting on
21 the substance of the transaction that is and has been
22 occurring.
23 If changes are made to the terms of what we've
24 deemed the "substantive plan," which is kind of the term
25 that we've used -- and we've borrowed that from our

1 friends at the FASB -- but if changes are made that alter
2 the terms of this arrangement, then certainly those are
3 going to be, and should be reflected in the measurements
4 that go into the actuarial valuation process and flow
5 through the financial statements.
6 So if, for example, a government decides to
7 curtail the benefits that are provided in some way, that
8 will be reflected; and, in fact, the standards require a
9 new actuarial valuation be performed if a significant
10 change has occurred.
11 So the accounting and financial reporting is
12 attempting to, in the most transparent way, represent the
13 transactions that the government has entered into. And,
14 again, we view it as an exchange. These employees have
15 been, are rendering services with the understanding that
16 there is something being provided as compensation for
17 those services. And that really underlies the board's
18 entire approach in this area.
19 MR. YOUNG: And that's an important distinction
20 from the standpoint of credit also, and the jurisdictions
21 that OPEB obligations are tantamount to pension and have
22 constitutional protection. They're rock-solid and cannot
23 be changed. And in other jurisdictions where they can be
24 altered, it's going to have a tremendous effect on those
25 two governments.

1 CHAIR PARSKY: Yes, for sure.
2 Paul?
3 MR. CAPPITELLI: Thank you.
4 First of all, I wanted to echo what has been
5 said, which is this has been extremely informative having
6 you come here today, and we appreciate your time.
7 My question is -- I just want to make sure I
8 understand correctly. I think we've had a sense of
9 impending doom that effective June 1st, 2008, all of a
10 sudden now everything is going to come to a grinding
11 halt. And I think what I've heard here today, if I've
12 heard you correctly, is that as long as agencies and
13 entities are either meeting the requirements of GASB and
14 have their funding levels in order and there is no
15 unfunded liabilities that are concerning to you, or if
16 they're doing something proactively to try to remedy the
17 situation that's acceptable, then, therefore, it's not
18 likely that we're going to have this immediate adverse
19 effect on their credit rating.
20 I understand there's other factors involved;
21 but would that be correct to say?
22 MS. BARZEL: Yes, as long as people understand
23 their situation and they are taking steps to deal with
24 it; and as long as what they are doing is consistent --
25 and this is a very difficult thing to say -- but as long

1 as it's consistent with what other others in the
2 community are doing as well, because, again, all these
3 ratings are relative.
4 MR. CAPPITELLI: The other question I have is,
5 how does California contrast with the rest of the
6 country? I mean, are you in great demand to travel all
7 across the country and make appearances as you're doing
8 here today to clarify, or is California one of those
9 that's a little different? I'm just curious.
10 MR. YOUNG: You're not alone.
11 MR. CAPPITELLI: Thank you.
12 CHAIR PARSKY: I think I would emphasize,
13 though, the point that you made about you look at that
14 entities are taking steps to deal with what they
15 recognize are the issues. So I think it is accurate to
16 say that "impending doom" is not the right way to
17 characterize things. On the other hand, being complacent
18 is not, either.
19 MR. CAPPITELLI: That's correct.
20 CHAIR PARSKY: Do you agree?
21 MS. BARZEL: I completely agree.
22 MR. CAPPITELLI: That's what I mean, too.
23 CHAIR PARSKY: Okay, well, thank you all very
24 much.
25 We'll turn to our next panel. We really

1 appreciate your time.
2 Thank you very much.
3 MR. COTTINGHAM: I actually have one thing.
4 Impending doom would be one thing. I think Mr. Richman
5 and Mr. Moorlach would look at that -- would appraise
6 that differently.
7 But since you're traveling all over the United
8 States and you've created such mischief with GASB, have
9 you ever thought of going back and withdrawing it?
10 I had to ask.
11 MS. CZERKAWSKI: And must I answer?
12 CHAIR PARSKY: Thank you very much.
13 Okay, our next and final panel today, thanks to
14 the good graces of our other two panels that said they
15 would present at our next meeting, we're going to talk
16 about having an actuarial overview. And I hope people's
17 eyes don't glaze over with this because I think we have
18 some very interesting presenters.
19 First, John, you're going to go first; right?
20 Or no?
21 Okay, Paul, why don't you introduce yourself;
22 and then we're going to divide this up into an actuarial
23 overview relating to pensions, and then an overview
24 relating to health benefits.
25 MR. ANGELO: Thank you, Mr. Chairman.

1 Good afternoon, Members of the Commission.
2 My name is Paul Angelo. I'm a consulting actuary with
3 The Segal Company in our San Francisco office. And it's
4 always a good idea at the end of the long day in a warm
5 room to have a bunch of actuaries to talk to. So we're
6 taking that opportunity.
7 CHAIR PARSKY: That's just the way we planned
8 it.
9 MR. ANGELO: I know. That's good.
10 Our office is in San Francisco, so we really do
11 focus primarily on the pension side. We do OPEB
12 valuations as well, and I work with our colleagues here
13 in the arena.
14 My comments will start with an overview on some
15 of the funding concepts that apply to both OPEB and
16 pensions; and then I will continue on to talk more about
17 some of the history of public pensions in California and
18 how they reacted to the events at the turn of the
19 century.
20 Our experience is based on, we are the
21 valuation actuary for eight of the larger county systems:
22 Orange, San Bernardino, Ventura, Contra Costa, and
23 several others. We're also the actuary for three of the
24 large city systems, and we're the actuary for the
25 University of California.

1 We've been doing this since about 2002, which
2 I can tell you was an interesting time to get into the
3 pension consulting business. Like I say, anybody can do
4 this stuff in an up market. But we showed up really in
5 the era of when the actuaries really became the Bad News
6 Bears, and worked with the systems in terms of dealing
7 with the progression of costs early in this century.
8 Now, I apologize a little bit, the outline that
9 is in your book is a little more detailed and is
10 impossible to read because they put three slides on one
11 page. So what I'm working from here, what I just passed
12 around, it's the same page numbers as what you have in
13 the book, and also it is on the Commission's Web site.
14 But there's a little more detail in the one that's on the
15 Web site than the one that you have before you.
16 So we're going to talk a little bit about how
17 you fund retiree benefits. And there's a little
18 terminology and a little bit how the numbers behave. And
19 this will apply both to OPEB and to pension, and then a
20 little bit about the environment that public pensions are
21 in. Some of this you've already talked about today,
22 DB/DC and a little bit on financial economics, a little
23 survey of what -- how public plans, pension plans are
24 laid out in California.
25 And then what I really think would be the most

1 useful history and data for the Commission to consider
2 is, you know, for pensions in particular, how we got
3 where we are today.
4 There were comments made at your first meeting
5 that the pension situation and the OPEB situation are
6 different, in that OPEB, you're kind of figuring it out
7 from scratch. Whereas pensions, there's a lot of
8 information that's already there. So what I'm hoping to
9 do today is really, on a factual basis, go through some
10 of that history.
11 Now, the one thing, if you're funding a
12 retiree benefit, when you get to the actuarial part --
13 and this is really the first conversation you've had
14 today that gets technical about where these numbers come
15 from -- there's assumptions, and you've talked already
16 about funding methods, and amortization periods and all
17 those things, but you should write on the back of your
18 hand what we tell our trustees to do, which is that
19 C + I = B + E, which is that ultimately, contributions
20 and investment income provide benefit payments and
21 expenses. That seems awfully simplistic, but you'll find
22 in a lot of situations pulling back to that level of
23 clarity will be helpful.
24 The assumptions and the methods that we talked
25 about are timing issues and budgeting issues, but

1 ultimately, you've got to actually earn the money or make
2 the contributions.
3 Now, the terminology that you'll hear, you've
4 heard the term "ARC" already. Well, ARC is already a
5 composite number. And it is made of two things, and one
6 is called the normal cost and one is called the
7 amortization of the actuarial unfunded liability, which
8 is a lot to say quickly.
9 The real focus, especially on the pension side,
10 is on the normal cost. That is, if you want to know what
11 each year of service costs as an add-on to the rest of
12 the benefit package, we would urge you to start and end,
13 really, with the normal cost.
14 One thing about the normal cost is that it is
15 independent of your funded level. Assets high, assets
16 low. The normal cost is -- for the Neil Young fans, it's
17 like "Rust Never Sleeps." This is sort of -- it accrues,
18 and it accrues with service, and it is designed so that
19 if you fund it, if you contributed to normal cost every
20 year during the years of active service for the employee,
21 at retirement, you would have enough money on a
22 present-value basis to fund that person's benefit. But
23 it is a budgeting tool.
24 Now, this accrued liability number,
25 counter-intuitively, it is not the amount that the

1 members earned. It is actually not connected to how much
2 the member would get if they quit or how much you would
3 pay if you shut the plan down today. This is a little
4 known fact. It is really a budgeting tool. And what it
5 says is, if you had paid the normal cost every year in
6 the past, and if today's facts had always been true, what
7 would you have in the plan? So that's kind of your "as
8 if" asset number. You compare that to the real assets,
9 and that gives you the infamous unfunded actuarial
10 accrued liability, assuming that the assets are less than
11 that liability, and you have an unfunded liability.
12 Now, the other way, though, if you had a
13 pension plan at the turn of the century, as you've heard
14 said by many of the Commissioners and other speakers, you
15 actually had a surplus. So you have a situation where
16 the assets were greater than what you would have simply
17 accumulated if all the assumptions were true. And so
18 that gives you a surplus.
19 Now, the way that these work in contributions
20 is pretty straightforward. If you have an unfunded
21 liability, it means that just paying the normal cost is
22 not enough. And the unfunded liability tells you how
23 much you're short on a value-today basis.
24 It goes the other way. If you have a surplus,
25 it means that over time, if you pay the normal costs

1 forever, you end up with too much money, so you actually
2 are ahead of your funding game.
3 And this is where the amortization period,
4 which I'm going to harp on quite a bit in the latter part
5 of this talk, the amortization period becomes crucial,
6 and there's an inverse relationship here. If you have an
7 unfunded liability -- I think you've probably got your
8 hands on this one -- the longer period you take to
9 amortize it, the lower your current costs will be; but
10 the longer you're going to have to live with that
11 unfunded -- and this is where people talk about
12 intergenerational transfers and putting burdens on our
13 grandchildren, those kinds of things.
14 If you have a surplus -- and we had surpluses
15 in this state in the turn of the century -- it goes the
16 other way. The shorter your amortization period, the
17 lower your costs are, because you're basically taking
18 that good news, that unexpected good news and you're
19 taking credit for it faster. So you really -- you know,
20 when you're in an unfunded position longer, you know, it
21 tends to raise alarm bells.
22 Well, maybe what we didn't know at the turn of
23 the century was that if you are in a surplus position
24 shorter, it raises the alarm bells.
25 Now, I also want to make it very clear, this is

1 20/20 hindsight. We're not saying that all these things
2 didn't make sense at the time. But we are saying that
3 with the benefit of the experience that we have,
4 especially on the pension side, we need to keep an eye on
5 surpluses as much as we do on unfundeds.
6 There's an irony here. If our OPEB benefits --
7 and I'll say this to my colleagues, and I'm sure they'll
8 agree -- if our OPEB benefits were as well funded as our
9 pension benefits, we'd be having very different
10 conversations today.
11 So you may be tempted to say, "What's the deal
12 with pensions? They're 80, 90 percent funded. Why can't
13 we just talk about OPEB?"
14 Well, I think that there is a lot of
15 information, as we see on the slide here, for pension
16 plans, you know, you really -- let me start again.
17 Pension versus OPEB gives you an idea to see the two
18 opposite ends of the funding spectrum. Where you are
19 with OPEB right now is where you are when you're just
20 getting going, and that certainly raises a lot of hard
21 issues.
22 As it turns out, when you get to the other end
23 of the spectrum, when you get to where a plan is fully
24 funded, your assets and liabilities are equal, and all
25 you have to pay is the normal cost; you know, you still

1 have policy issues. And I think a review of the history
2 at the turn of the century will show you what those are.
3 So as challenging as underfunding is -- and
4 that is really your great burden as a commission -- at
5 the policy level, overfunding also raises policy issues
6 that we would want to bring to your attention.
7 So, now, I'm going to be real fast DB/DC.
8 You've heard a lot about DB/DC here.
9 The actuary perspective is one I think does not
10 necessarily show up in every conversation. Go back to
11 C + I = B + E. And basically, in a defined contribution
12 plan, "I" is lower and "E" is higher. And so you're
13 either going to have more "C" or less "B." You can do
14 the math there.
15 Now, you can have a debate on the "I," whether,
16 in fact, individuals can earn as much as an institutional
17 investor. There's a recent survey that shows that the
18 individual accounts are earning an average of 1 percent
19 less. I was surprised it was only 1 percent. But you
20 can look for data on that. Just this month, I saw
21 something that shows that money market accounts earn less
22 than institutional pension money because of the expense
23 side. They're agency costs that increase the "E." So
24 we can have a debate, I suppose, on whether DB plans or
25 DC plans earn more during the accumulation period, that

1 is, while people are in their active years of service.
2 Where there is no debate is at retirement.
3 Because in a defined contribution plan, the only way that
4 the member get out of the risk game -- that is, get out
5 of the investment volatility risk, and most especially,
6 the longevity risk is to buy an annuity. If you buy an
7 annuity, you are moving into bonds. And so you have
8 reduced your capital "I" from 8 percent to 5 percent.
9 So the principal advantage that a defined
10 benefit plan offers is that you can continue to earn a
11 balanced portfolio, 60/40 kind of mix, during the
12 retirement pay-out because, after all, the plan is not
13 retiring, only the member is retiring.
14 And I do not know any way to recreate that sort
15 of economic advantage in the defined contribution plan.
16 I also resent the term -- you'll hear -- in
17 fact, if you read the Richman proposal that was from a
18 couple years ago, the Richman/Jarvis proposal, it talked
19 about comparing a DB pension plan and a DC pension plan.
20 There is no such thing as a DC pension plan. It's an
21 oxymoron. Because a pension is a series of payments. It
22 is not an account balance, not an individual account.
23 And so until you deal with the annuitization
24 risk, you're not really talking about benefit security.
25 And as I say at the top of this slide, our task

1 here, if I had to summarize it in a sentence, is to
2 convert taxpayer dollars into retirement security for the
3 people who spend their lives in service to the taxpayers.
4 And on this analysis, a pension plan is simply a more
5 efficient economic engine for converting those
6 taxpayer dollars into true retirement security, which
7 means an income that lasts as long as you live. So
8 that's the sermon.
9 Another thing that you will hear as you talk
10 about measuring liabilities -- I hope you don't, but it
11 may come up -- is financial economics. There is a move
12 within the actuarial community, it started about 2003,
13 it was called the "Great Controversy." Imagine actuaries
14 having great controversy. And it was, are we
15 fundamentally mismeasuring our liabilities? You know,
16 should we be using basically bond rates, should we be
17 measuring our pension liabilities as though they were
18 bonds? And the argument is, they are a stream of
19 payments. A bond is a stream of payments. They have
20 something called a law of one price, which says if there
21 are two streams of payments, they should have the same
22 price. And so the idea that by taking on more risk in
23 your investments, you lower your liability, which is what
24 happens when you invest in equities. They say that this
25 doesn't make financial statements.

1 Well, I think that's perfectly true if you are
2 talking about a corporate plan. Because a corporate plan
3 ultimately can be terminated, and you can be forced to go
4 to the market. Whereas a public-sector plan, they simply
5 don't terminate. There is no market out there for buying
6 and selling the liability of a public-sector plan.
7 Whereas there is a very defined market for doing so in a
8 corporate plan.
9 So if that comes up -- I can save you some
10 time. The question is should public plans measure their
11 liabilities according to financial economics? The answer
12 is no.
13 Now, that's our brief summary of sort of the
14 two environmental factors.
15 In Grant Boyken's summaries that he put
16 together, he has sort of an overview of public plans in
17 California. I won't go through too much detail. CalPERS
18 is dominant in a number of ways -- first of all, it is
19 the mandated retirement system for the state employees.
20 It is very much a policy leader in terms of pension
21 practice because of the agencies. That is, any number
22 of individual local employers basically get their
23 pension benefits from a menu that's provided by CalPERS.
24 Then come the county systems. This is very
25 distinctive to California. You have this group of

1 20 counties. It's 20 -- it's actually 14 of the
2 17 largest counties. It's most of the large counties
3 which are independent systems operated under a common
4 legal framework. And these are the so-called 1937 Act
5 or 1937 CERL counties.
6 There are two independent counties,
7 San Francisco and San Luis Obispo. All the other
8 counties are CalPERS agencies.
9 There's a table here that has them all listed.
10 And then you have, as in Grant's write-up,
11 there's about 32 or 33 independent city systems. The
12 largest ones are the three LA plans. And the LA plans
13 are actually as large as any of the counties, except
14 Los Angeles County. So the LA city plans are, generally,
15 the same size, more or less, as Orange and San Diego, the
16 very largest of the non-LA County plans.
17 Another interesting comparison is -- you have
18 CalSTRS is the other independent system, 140 billion, and
19 then the University of California, which coincidentally
20 is about the same size as LA County. They're both about
21 $40 billion in assets, both about 120,000 active members.
22 So when you talk about statewide solutions,
23 there's a lot of discussion here about local control, you
24 have a fairly complicated mix of plans; but it's not just
25 like in a lot of states where there's a big state plan

1 and a lot of independents. This county structure adds an
2 additional layer of systems that are comparable but
3 nonetheless independent.
4 The last thing I'll mention here gets to really
5 something that the auditor -- that the GASB folks were
6 touching on, and the bond underwriters were talking
7 about, and that is, in a lot of states, whoever it is
8 that comes up with the retirement contribution sends the
9 bill to who is going to pay it, and maybe it gets paid or
10 maybe it doesn't. Or maybe the same group that has to
11 come up with the money sets the contributions. There are
12 states where the pension, state pension systems are run
13 by a committee of the state legislature. Think about
14 that for a second.
15 Well, what you have in California dating back
16 to 1992 is a governance structure that I believe is a
17 model for the nation. Now, we can talk about whether it
18 always works and everything else, and is it overreaching;
19 but the idea that you have independent boards -- and, of
20 course, counties, most of our experience, you have
21 independent boards that come up with a contribution
22 requirement, and they send the bill over to the employer,
23 and the employer has one choice, and that is, it will pay
24 that bill.
25 Well, this pretty much puts aside a lot of the

1 issues that I think affect the bond underwriters, because
2 there really is -- and I think what they said was, if
3 you have a system where it's clear that the contribution
4 will be paid, well, that's exactly what you have in
5 California, and it really goes back to Prop. 162, the
6 dates in 1992.
7 So that's sort of our overview.
8 And, Mr. Chairman, you will caution me when I
9 get to time, I trust?
10 CHAIR PARSKY: I'm cautioning you.
11 MR. ANGELO: Okay, thank you. That's why I
12 asked. Thank you.
13 Okay, well, what I'm talking about is what
14 happened at the turn of the century. The market spike --
15 you know, if you wanted to mess with the pension system,
16 the worst thing you can do is not to have the assets go
17 down. If you want to really mess with it, what you do is
18 have the assets go up first and then go down. And that
19 is what happened.
20 And as it happened, this was at a time when
21 because planners were well-funded, partly because of
22 pension obligation bonds which for the counties started
23 around the mid-nineties, there was some actuarial
24 arrogance going on, in that we thought that, you know, we
25 can manage this volatility. And so what we had was very

1 short amortization periods. We figured -- and this is
2 also part of the federal tax law in 1987 for
3 corporations. It was shorted for gains and losses, from
4 15 years to a five years. So we thought this is just
5 going to be wiggle; right? A little bit of wiggle. We
6 get it paid for in five years. What we didn't anticipate
7 is that it was going to wiggle up. And so what happened
8 was you got in a situation where you could have a
9 relatively small surplus. And instead of gradually
10 reducing your contribution, it would knock it to zero.
11 And, again, ignoring compound interest, if you have a
12 surplus equal to five times your normal cost, which was
13 very typical, and you have a five-year amortization
14 period, that means you're going to contribute zero for
15 five years.
16 Now, there's a term that we have used for the
17 surplus, which is probably not correct but we call it
18 "*actuarial heroin*," only because it's something that you
19 kind of get used to and then it goes away, and then
20 you've got to sell the TV.
21 There's a certain amount of that that happened here
22 because --
23 CHAIR PARSKY: Do you have a TV show?
24 MR. ANGELO: I do not. I do not.
25 I debated whether to -- well, it turns out to be a

1 fairly --
2 CHAIR PARSKY: I'm giving you a warning, sir.
3 MR. ANGELO: Yes.
4 All right, so because of the very short
5 amortization periods, what we had was, we had
6 contribution holidays, which had two impacts.
7 The first was that the employers, in doing their
8 budgets, got used to having a zero as the line item for
9 pension expense; and the other was that it raised issues
10 of fairness.
11 There's a source document, which you can go
12 back to, it's the Public Retirement Journal, July of
13 1999. And that's a key date, because you remember, they
14 didn't know what was coming. This describes the
15 environment. And CalPERS was a leader in this
16 discussion. And the idea was because the surpluses are
17 only providing contribution reductions for the employers,
18 how do we share the good news with the employees? This
19 led to the development of the new benefit levels, which
20 were mandatory for state agencies and were optional for
21 local agencies within CalPERS; and then there's also a
22 "me, too," effect, that is within the counties and the
23 other local governments that would do it, as well.
24 Two other CalPERS policies which were crucial
25 here, and that is, in an effort to encourage adoption of

1 the new benefits, they took action with regard to the
2 actuarial value of the assets. Now, we're not going to
3 go into that here, clearly. But what they said was,
4 "We will increase your asset value that you get to count
5 in doing your contribution calculation only if you adopt
6 a new benefit." So they basically made gains which were
7 deferred from this smoothing period, if you know about
8 smoothing, they took some of those gains and said that
9 they would accelerate recognition of the gains to help
10 you cover the cost of the new benefits.
11 That was first done in 1999, and it basically
12 moved up to 95 percent of market. That would have been,
13 you know, one level of policy.
14 The interesting one is -- and now I go to
15 another issue of the Public Retirement Journal in May of
16 2001 -- now the original policy had expired, but the
17 momentum for benefits was still there. The market had
18 now turned. Remember, the first down year was 2000. The
19 market started to turn. The actuarial value was already
20 bigger than market, and CalPERS adopted a policy -- now,
21 at this point was not mandatory, but it was an option to
22 the local agency -- that they would actually move your
23 actuarial value from 105 percent of market, to
24 110 percent of market, in round numbers, if you adopted a
25 new benefit formula.

1 So there clearly was a belief that these
2 surpluses were part of the environment and were a
3 legitimate source for funding the new benefits.
4 This has its impact on the collective
5 bargaining environment.
6 I will jump to our current state, which is with
7 the benefit of hindsight, CalPERS in 2005 did an
8 exhaustive review of funding policies. And these, I
9 would very much call to your attention as the sort of
10 things that we've learned of what you do, you know, now
11 that you know what the effective surplus can be. They
12 went the opposite of what you'll hear all the corporate
13 folks talking about. Instead of marking to market, they
14 actually moved away from market. So instead of
15 three-year smoothing, 15-year smoothing. What ever that
16 means, it's more smoothing.
17 What this would have done at the turn of the
18 century would be to stretch out those gains further.
19 The key here is surplus. If CalPERS ever again
20 finds itself in a surplus position, instead of taking
21 credit for that in contributions over five years, they
22 would mandatorily stretch it over 30 years, which
23 basically dilutes the surplus severely.
24 So these I think would be funding policy
25 considerations that you could take into account, and then

1 there were things here about benefit adoption procedures,
2 the question about whether to do a popular vote or not.
3 You will get different information. You have some
4 jurisdictions where even though there was a popular vote,
5 they did adopt new benefits. Some, where even though
6 there was no requirement for popular vote, they didn't
7 adopt the new benefit. So it's not really controlling.
8 And then the last thing would be on future
9 benefit levels, you know, I understand that there is sort
10 of an issue of mandate here, and that is, are we focusing
11 on liability, are we looking at redesign?
12 I would give only one proposed consideration
13 for you. There's a lot of talk about coming up with a
14 new plan design that would apply to everybody. Well,
15 we are in the plan-design business, and I do not pretend
16 to come up with a single plan design that would fit all
17 the counties and all the jurisdictions and all the
18 agencies.
19 If you find yourself -- and this is a big if --
20 if you find yourself in the situation of looking at new
21 benefit designs for new hires, you might consider going
22 to each local jurisdiction; and instead of imposing a
23 new formula, look at their history of formulas and
24 perhaps just dial it back. I know it's not a pleasant
25 consideration; but if you are looking at a lower benefit,

1 what do you do about the jurisdiction that never raised
2 benefits? Why should they even have a new benefit
3 imposed on them?
4 So one way to do this would be to look at the
5 history at the local jurisdiction and craft your solution
6 to take their actual historical actions into account.
7 Thank you.
8 CHAIR PARSKY: Thank you.
9 Paul thought that we should ask him questions
10 first because we would forget about what he said.
11 Given his sense of humor, I don't think that
12 will be the case.
13 MR. BARTEL: So just to be clear, I'm not going
14 to forget what Paul has said.
15 CHAIR PARSKY: So let's finish our panel
16 discussion and then we'll come back and ask questions.
17 MR. BARTEL: One of the things that's
18 interesting, just to be clear, you all know this, I'm
19 sure you know in some life another actuary, I have no
20 great sayings, like "*actuarial heroin*," so those of you
21 who need a nap will probably be able to take it now.
22 I'm John Bartel. I am president of a very
23 small actuarial consulting firm, Bartel Associates. We
24 have 15 employees. We represent a bit of a different
25 market than the Segal Company.

1 We do a fair amount of actuarial work. 95,
2 98 percent of our work is really for California public
3 sector entities. The majority of those are special
4 district cities, counties. Over half of our work is
5 related to GASB 45.
6 So I have a relatively short presentation. But
7 one of the things I was fascinated by, were the questions
8 of the prior panel. And with your permission, I'd like
9 to maybe try to answer a couple of those questions rather
10 than getting into my presentation.
11 Would that be okay?
12 CHAIR PARSKY: That's fine.
13 DR. GHILARDUCCI: Please.
14 MR. BARTEL: You asked a lot of great
15 questions, but I wrote down five that I thought were
16 particularly interesting and probably should be
17 discussed -- I'm not sure what my fellow panelists will
18 say on this.
19 One of the very first questions you asked:
20 Should you have a standardized set of actuarial methods
21 and assumptions?
22 So the short answer is: No.
23 The long answer is: Would you really want to
24 have a standardized practice of medical procedures for
25 somebody who is coming in for a diagnosis? And the

1 answer is: Perhaps, depending upon what they're coming
2 in with; right?
3 But when you look at some of the numbers I'm
4 going to show you in a couple of minutes here, you're
5 going to see that the level of promise, the nature of
6 benefit from one agency to the next is gigantic. It's
7 unbelievably different from one agency to the next.
8 For you all to be able to come up with a
9 standardized set of methods and assumptions, I will
10 suggest to you will be virtually impossible.
11 Let me give you a slightly left-turn
12 recommendation, and that recommendation is rather than
13 having a standardized set of assumptions, why not
14 establish a panel, populated at least in part with
15 actuaries who can review assumptions and methods for
16 reports that are prepared for California public agencies?
17 Now, I hate to suggest another level of
18 bureaucracy, but at least then what you do is you put
19 people who are qualified to make the opinion in the line
20 of fire. And, frankly, that's where we, as actuaries,
21 really ought to be.
22 One of the things that actuaries have done a
23 horrible job at, just a brutally bad job at, and that is
24 explaining how rigorous we are and how good we are at
25 our job. And the reason we're horrible at that is

1 because we don't become actuaries to stand up here and
2 talk to you all. We become actuaries because we like
3 numbers. We like sitting behind computers doing
4 calculations, and that's really what most of us do.
5 So you don't very often hear actuaries standing
6 up and kind of defending themselves; but what you would
7 hear me say is, I think you would be making a big mistake
8 if you come up with standardized methods and assumptions.
9 So that's question number one.
10 Question number two is the funding method --
11 there was a comment, I want to say it was Parry Young who
12 said that the majority of retirement systems around the
13 country used entry-age normal. That has not always been
14 the case. Most have moved to entry-age normal for
15 really very good reason, and that is, it generates cost
16 contributions as a level percentage of pay, which works
17 really well in the public sector budgeting model, if you
18 will.
19 And so I think most retiree health-care
20 systems, when they look at that, will move to an
21 entry-age normal funding method. That's part one to
22 that.
23 There are, in fact, other actuarial funding
24 methods which will generate lower, in some cases, higher
25 numbers.

1 So you can, in fact, if you play with the
2 funding method, you can, in fact, change the numbers.
3 But I think you will see if employers
4 understand what the actuary is saying, most will move to
5 that entry-age normal.
6 There was a couple of comments or questions on
7 the discount rate. What you would hear -- and the
8 impression that I had was that there might be some
9 skepticism or some concern that an agency might select
10 a discount rate that would -- perhaps might show the
11 liability is maybe lower than it should be.
12 What you would hear me say is, that ain't going
13 to happen with any of my clients, and it ain't going to
14 happen with any actuary who is really meeting actuarial
15 standards of practice, period.
16 Does that then mean that all agencies should
17 be using the same discount rate? No, it does not. If
18 you think for a moment, we have clients who I suspect
19 will probably continue some sort of level of
20 pay-as-you-go. And when we look at the underlying rate
21 of return of their general fund, we do, in fact, see
22 quite different levels of rates of return of history; and
23 that's really what the actuary needs to be looking at, is
24 what rate of return has the agency earned, and what might
25 they earn in the future?

1 Now, there is some judgment there. But the
2 review of the outside auditors, the review of the
3 bond-rating agencies, I think, will really mitigate any
4 fluctuation that you might see or any interest in
5 fluctuation.
6 So -- and I feel -- if you can kind of tell
7 from my tone of voice, I feel pretty strongly about that,
8 that if the actuary is really doing the job, then,
9 frankly, you should not be worrying about the numbers;
10 you should be worrying about how you deal with the
11 numbers. And so that's question number three.
12 Number four was a question that, frankly, I
13 thought was really an interesting question, and that was,
14 in the footnote, does GASB require any explanation for
15 the change in liability from one year to the next? Well,
16 the answer to that was very simply no. But, really, the
17 question is, should they. What you will hear me say is
18 one of the challenges -- the single-most difficult thing
19 in presenting an actuarial valuation, particularly one
20 for an agency where this is a second valuation, is why
21 did the numbers change from the prior year to the current
22 year? Volatility, we just went through huge amounts of
23 volatility in pension contribution rates. You ain't seen
24 nothing. The volatility of the health-care rates from
25 one year to the next is just huge.

1 Does that mean that the numbers are unreliable?
2 No. It means that the number was the best guess at the
3 time; and the actuary's job is to explain why it went
4 from point A to point B. So that explanation in
5 understanding why the numbers are moving, I frankly think
6 is extremely important.
7 So what I wanted to do is just very, very
8 quickly go over a couple of things that I thought you all
9 might be interested in. Rather interesting to me, one of
10 the very first questions I got early on when we were
11 doing -- what I'll call GASB 45-compliant valuations
12 were, "Man, our numbers are big. How do we compare with
13 everybody else?" So one of the questions I really
14 struggled with is part of your charge. How do you really
15 do that comparison? How do you understand the magnitude
16 of the numbers?
17 *(Mr. Pringle left the hearing room for the*
18 *day.)*
19 MR. BARTEL: And early on, we considered that
20 maybe we would go out and do a survey.
21 But, frankly, the more clients I talked with,
22 the more I really recognized that they all use different
23 terminology to mean the same thing, or -- thank you very
24 much -- the same terminology to mean something else.
25 And so English ended up getting in the way of

1 doing that sort of a survey. And benefits are hugely
2 different, the health-care plan options in retirement are
3 hugely different.
4 Within an agency, if you go out and do a
5 survey, you might have provisions for one or two
6 different benefit structures. We had agencies that have
7 12 different benefit structures for one agency,
8 12 different bargaining groups.
9 And so getting a response, a reasonable
10 response in a survey, brutally difficult.
11 And then you have the added complexity that
12 typically, not always -- typically, the person who
13 completes the survey is not the person who knows the
14 answer.
15 So, really, there's no -- what I'd like to do,
16 I'm going to skip over for a moment slide 4.
17 I'm only going to skip over that for a matter
18 of time. I would kind of encourage you, that's actually
19 an approach to dealing with the issue that we think a
20 fair number of agencies in California are going to adopt.
21 What I thought I would do, though, is go
22 through a series of graphs.
23 CHAIR PARSKY: I wouldn't say a series of
24 graphs, because we want to make sure we complete this
25 program.

1 MR. BARTEL: Fair enough.
2 Trying to answer that first question, how do
3 our numbers compare with other agency's numbers, what we
4 tried to do was to take the actuarial information and
5 express it as a percentage of payroll, really under the
6 theory that most public agencies have a revenue stream
7 tied to payroll. And, frankly, we don't know what an
8 agent's revenue stream is. We do know what the payroll
9 is because we ask for it.
10 So you'll see the next two slides. And I'm
11 just going to tell you very quickly what's here rather
12 than looking at the detail.
13 But slide 6, what we show here is the
14 actuarial-accrued liability for miscellaneous or general
15 non-safety, compared to safety. And these are as a
16 percentage of what I'll call for a moment a pensionable
17 wages or PERS-able wages. And what you see is, our
18 client with the lowest actuarial liability as a
19 percentage of payroll was at 11 percent, and the highest
20 for miscellaneous was approaching 400 percent. And the
21 variance in those is huge.
22 And then if you take a look at slide 7, slide 7
23 shows the normal cost, Paul did a great job of explaining
24 what normal cost and annual required contribution are.
25 But you see those numbers.

1 And then rather interesting, too, is
2 pay-as-you-go current as a percentage of payroll, and
3 pay-as-you-go 10 years from today as a percentage of
4 payroll.
5 So arguably, this is why we're talking about
6 this. We're talking about, will an agency have a budget
7 issue ten years from today or 20 years from today due to
8 retiree health care? So that's -- now, let me just tell
9 you what the database is here.
10 We have done about 130 studies. That is a very
11 small number when you look at the agencies around the
12 state.
13 So you would not hear me say this is
14 necessarily a representative cross-section. These
15 numbers, however, do seem to be consistent with other
16 studies we've seen.
17 I'm going to skip for a moment to slide 13. We
18 kind of saw this graph. Parry Young put it up. This
19 happens to be an actual graph for one of our clients.
20 The blue line is the pay-as-you-go line over the next
21 30 years, prepared on what the actuaries will understand
22 to be an open group projection, meaning, we took into
23 account future hires, and the 20- and 30-year
24 amortization of the ARC. And, frankly, this is what
25 makes prefunding -- this graph is what makes prefunding

1 so difficult.
2 What we're really saying here is, over the next
3 30 years, thank you very much, you will be paying a lot
4 more than if you keep going on a pay-as-you-go basis.
5 So this is a typical graph that you see.
6 Let me just show you the next graph. And this
7 is the cousin, if you will, to that first graph. And
8 this graph says if you do pay as you go, here is what
9 your unfunded liability is going to be in 30 years. And
10 if you do, like, 20- or 30-year amortization -- and my
11 little caveat if all assumptions are met -- here is what
12 your unfunded liability is going to be in 20 or 30 years.
13 So what you're really getting for that extra
14 payment of cash is taking care of your unfunded
15 liability.
16 Now, that's easy for the actuary to say; right?
17 Very difficult for the elected officials to execute.
18 So I decided -- this is not a scientific test.
19 If you had asked -- what I decided I would do was go back
20 and think about my clients and make my best guess as to
21 whether I think they will prefund or not; and if so, at
22 what level? In fact, at what level?
23 One of the things that's fascinating to me is
24 probably four years ago, I wrote down a little figure,
25 and I said, "I think less than 20 percent of public

1 agencies will prefund at any level."
2 I am convinced I was wrong about that. What I
3 really misunderstood were a couple of things. One is
4 how seriously clients are taking these numbers, and how
5 seriously I think the public officials are taking these
6 numbers. So it's really a combination of those.
7 So paying the full ARC, I think that's going to
8 be a very small percentage. I think that 10 percent is
9 probably high.
10 And so some sort of a phase-in to the annual
11 required contribution. I actually think most agencies
12 will take that approach.
13 Consider a target funding level. In other
14 words, really saying, should we be 100 percent funded in
15 20 or 30 years? Maybe what we ought to do is have a
16 lower target level, and maybe that's a better use of
17 public funds. We think that's a challenging thing for
18 agencies to do and approach for them to take. We think,
19 however, some will take that approach.
20 Unknown, because I'm an actuary, I left myself
21 an awful lot of wiggle room, and I have now moved from
22 80 percent, down to 20 percent in terms of "Continue
23 pay-as-you-go."
24 Now, again, in the interest of full disclosure,
25 our client base is cities, counties, special districts.

1 We do not do much work for school districts.
2 I was particularly interested in the comments
3 of the gentleman from the school district earlier. And I
4 would probably encourage you to listen very hard to what
5 he had to say, because I think the funding mechanism --
6 their approach to this will be significantly different
7 than most other agencies. Our clients versus school
8 districts.
9 So this is likely not representative, but it's
10 kind of my best guess.
11 One of the things we've really spent very
12 little time on --
13 CHAIR PARSKY: This is going to be your last
14 slide.
15 MR. BARTEL: Fair enough.
16 One of the things we spent very little time on,
17 really, was the uncertainty associated with the legal
18 issue. We've read several legal opinions as to whether
19 or not OPEB are or are not vested. The attorneys seem to
20 say no. But frankly, our clients aren't entirely
21 convinced that they agree with that. So they believe
22 there is a fair amount of uncertainty associated with
23 that issue.
24 I think the majority of agencies, when it comes
25 to plan changes, will make very few or little changes;

1 but I think the majority will bring these numbers into
2 the bargaining process. The numbers are almost too big
3 to do anything else.
4 CHAIR PARSKY: Thank you.
5 Leslie?
6 MS. THOMPSON: Yes. Thank you, Mr. Chairman.
7 At this point, my slides are now obsolete and
8 redundant, so I'm just going to wrap up with a few
9 comments that lead us now into a discussion of the larger
10 framework of solutions. Not getting into the specifics
11 of solutions. But I want to talk with you about what I'm
12 seeing my clients do in terms of trying to get their
13 arms around this problem in an, I want to say
14 efficient -- I don't know if you can get your arms around
15 it efficiently, but in an effective manner.
16 There's three things that I have seen emerge in
17 the discussions that are coming from all of our
18 employees.
19 Number one is, above and beyond any other
20 concern, they want to be able to have access to medical
21 care. And it's coming out in the form of, "Please don't
22 cut me out completely. Let me have access." This is
23 important because in some cases, the only benefit
24 available is an access-only benefit, but the benefit is
25 the blended rate or the implicit subsidy. That is, they

1 get a lower premium cost because they have been blended
2 with the active employees.
3 Individual affordability then seems to be next
4 on the list. "Please make it affordable for me." And
5 that needs to be balanced then with sustainability and
6 predictability.
7 And I think one of the things that GASB has
8 done is it's helped us to see whether or not a benefit
9 is sustainable. And I mean that because I work with, for
10 example, a fire district that might only have three
11 retirees, so it's affordable today. But when you do the
12 GASB calculation and convert everything into a level
13 dollar, you can see it truly isn't sustainable. And it
14 seems that the objective of all of our employers is to
15 have a benefit that is both affordable and then
16 sustainable.
17 So I see those as the three overarching issues
18 that we're looking at, and that this tension of
19 allocating resources, not only between these three
20 issues, but allocating resources between all of our
21 programs has become a very bright-lined issue for all of
22 us.
23 There are three main approaches that I'm seeing
24 to attacking this GASB issue.
25 First is the management of claim costs. That

1 is the management within the underlying health-care plan.
2 That's been going on for a long time. Nothing new to any
3 of us. That's deductible, converting from co-pays, to
4 coinsurance, out-of-pocket, all that stuff that's going
5 on. That still needs to go on, just likes the WEFIT that
6 was talked about earlier today, putting in wellness
7 incentives. We have to manage our claim costs.
8 Second is the OPEB benefits themselves. The
9 management of those. And you've heard a number of
10 tactics today, whether it's tiering for new hires,
11 whatever it is. The way that I'm seeing that framed is
12 through looking at our generational contracts. What do
13 we owe retirees, what do we owe current actives, and what
14 do we owe new hires?
15 It is clear from the statement of this
16 commission, that we are settled on what our retirees and
17 actives in terms of meetings promises already made. But
18 new hires, I'm seeing the questions getting raised around
19 what do we owe them, and how do we remain competitive in
20 our marketplace, and what is going on competitively with
21 our new hires, and is it fundamentally different than the
22 retirees that we now have today?
23 And then finally on funding, I think the core
24 issue around funding is to optimize our resources without
25 having an adverse overall effect. The reason I say that

1 is, you could do something in GASB OPEB but then affect
2 your bond rating so the total cost -- you know, your cost
3 of capital goes up, and then you've impacted your entity,
4 you haven't gained anything economically. So that's why
5 you've got to work there between what you do with OPEB,
6 right, and the cost of capital. So that's why -- but
7 once you -- you need to settle on benefits first so you
8 know what you're funding and you know what your
9 commitment is. And then you can move to the funding
10 question of: Do we put it in a trust or not?
11 And the fears around irrevocable trusts seem to
12 center on, "Once I put the money in, is it really going
13 to be needed or am I going to not need it? I mean, I
14 have to know if the benefits are going to be there or
15 not."
16 So there are risks and rewards to funding as
17 well.
18 That's the highlight, that's the framework for
19 solutions.
20 Thank you, Mr. Chairman.
21 CHAIR PARSKY: Thank you very much.
22 Questions?
23 Yes?
24 MR. CAPPITELLI: Yes, I have a question.
25 Earlier today, we had some presentations where there

1 was some inference that somehow -- and I think it was
2 centered around the notion that if you need to fund the
3 deficit or fund the unfunded liability, you need to look
4 for some method. But if I heard all of you speak today,
5 one thing that came through to me is that the
6 calculations such as 3 percent at 50, those are based
7 on actuarial calculations and based on an understanding
8 of how much is going to be in the system, et cetera.
9 If you're going to start altering those
10 formulas, what you're doing, in essence, is you're
11 probably providing additional money or funding to be able
12 to put towards something else, unless you really have
13 miscalculated your actuarials. Would that --
14 MR. ANGELO: Speaking to the pension issue, you
15 know, you get to the question of is there a pension
16 crisis in California? I don't think we have a clear
17 answer to that yet.
18 I will tell you that as we present actuarial
19 reports, as we have done so for the last -- you know,
20 ever since 2002, you know, we have shocked a lot of
21 employers. And so what we hear at the meetings -- and
22 this is just tales from the road -- is that the level
23 of pension costs -- and I'm not speaking about the state
24 employer, because that's not where I work -- but the
25 level of costs, including the costs of the benefits that

1 were adopted at the turn of the century, are at least,
2 in the words of the employers, putting a burden on those
3 employers, and causing them to cut services. I mean,
4 this is what we hear over and over.
5 So the idea that by lowering the benefit that
6 this would somehow free up resources, that is not the
7 message I'm hearing from the employers. What it would do
8 is allow them to return to a more manageable level of
9 costs. That's the message that we hear from the
10 employers.
11 MS. THOMPSON: And don't forget that one of the
12 things brought up earlier today was to use a
13 tax-advantaged approach. Money out of a 401(a), the
14 pension plan, is not tax-advantaged, where out of the
15 retiree medical will be. That's another sourcing issue.
16 So not to contradict Paul, but --
17 MR. ANGELO: Yes, I was speaking, again, really
18 just on the pension side. Again, it was sort of a
19 parallel but related discussions, exactly. Exactly.
20 MR. LOW: I have two questions. You mentioned
21 this blended rate issue. We've been hearing from some
22 that you have to calculate the GASB unfunded liability
23 for the retirees separately from the actives unless you
24 have a plan that is community rated; is that true?
25 MS. THOMPSON: Yes.

1 MR. LOW: The second issue is, the cost of
2 health care, the assumption on the cost of health care,
3 I've been hearing, we've got these double-digit
4 health-care rate increases, and they're saying this is
5 going to kind of continue on into the unforeseen future,
6 which they are saying this is a reality, which it seems
7 to me that runs in conflict with the reality that if this
8 does happen over this 30-year period, then your cost of
9 health care is going to be about five times your
10 mortgage.
11 So what is your sort of assumptions on
12 health-care rate increases?
13 MS. THOMPSON: Well, all of us as actuaries, I
14 believe John piped in, too, but most of us, we start with
15 some double digits in earlier years, is it does trend
16 down.
17 MR. LOW: To about what?
18 MS. THOMPSON: In our case, we generally trend
19 down to 5. We'll go lower if you have some pretty
20 significant cost containment features, and we'll
21 recognize that. But it generally goes down to five for
22 an ultimate rate. And now, I defer to John.
23 MR. BARTEL: Yes, we're very similar to that.
24 Our ultimate rate typically is four and a half, not 5.
25 We grade to that four and a half over about a 10-year

1 period.

2 Frankly, we could have a very long conversation

3 because there are other actuaries who believe it will

4 continue at a much higher rate for a longer period of

5 time, and there are still other actuaries who believe

6 that we're at a crisis today, and a 5 percent health-care

7 trend for next year is appropriate.

8 So most don't fall into either of those two

9 camps.

10 MR. ANGELO: And there's a pattern that's

11 emerging there, which we try to discuss it with the

12 clients. And if you compare it from year to year, say,

13 our current assumption is 13 percent and it's going to

14 grade down to 5 percent over 10 years, because eventually

15 it has to go down, otherwise the entire economy turns

16 into the medical sector.

17 But then we come along next year, and it just

18 doesn't seem to have gone down yet. And so this 13, down

19 to 5, next year it's not 12 down to 5, it's still 13 down

20 to 5. So we kind of keep pushing this thing out, which

21 means in effect, we're actually increasing the assumption

22 each year. Because it's got to come down, but it just

23 doesn't seem to be happening yet.

24 So there's a little bit of an incomparability

25 from one year to the next, because the assumption looks

1 the same, but it's actually changing.
2 CHAIR PARSKY: Matt?
3 MR. BARGER: The question I had -- I have
4 another little technical question that I was interested
5 in here, which is the notion of actuarial value of
6 assets. I mean, I can understand about an actuarial
7 value of liabilities given all the uncertainties. I
8 mean, the notion that you don't actually know how much
9 your assets are worth strikes me as sort of improbable.
10 MR. ANGELO: No, it's not how much they are.
11 This is part of your funding policy. This is a policy
12 that you adopt.
13 If you remember how the cost is determined,
14 there's that amortization piece. Well, the market value
15 of pensions -- we're thinking of pensions now -- is quite
16 volatile. When the market value goes up, your unfunded
17 liability goes down, your cost goes down.
18 Rather than have your contribution vary widely
19 from year to year, we don't run the calculation on the
20 raw market value. We run the market value through a
21 shock absorber, which in effect means we take whatever
22 your gain or loss was each year; and instead of
23 recognizing it right now, which is what the market value
24 does, we spread it over five years -- typically five
25 years. So the actuarial value of assets is a technique.

1 It's not that we don't know exactly what the market value
2 is or we deliberately -- or, excuse me, our boards
3 deliberately do not use the market value. They, instead,
4 take a number that tracks market but dampens out the
5 short-term volatility. That's what the actuarial value
6 of assets is.
7 MR. BARGER: For year to year, though, in terms
8 of what the value is?
9 MR. ANGELO: Actually, the report will show
10 both numbers.
11 MR. BARTEL: Always?
12 MR. ANGELO: Always. But the ratio that gets
13 published, if you ask me how well-funded am I, that
14 generally is based on the actuarial value. Because
15 again, the only -- this gets back to the fact that the
16 plan is permanent. It's not going to be terminated.
17 The corporate plans, you almost have to look
18 at market because if you shut down, you take the market
19 value to market. Whereas if you can take that
20 longer-term perspective, you don't really need to worry
21 so much about the year-to-year volatility. And that's
22 why the consistent, ongoing funding progress is measured
23 on the smoothed value or actuarial value.
24 MR. BARTEL: In fact, if you think about this,
25 it makes a certain amount of logic sense. Your market

1 really is only money in the bank if you sell those
2 equities, if you sell. So it really isn't there until
3 you sell those equities and you get the money in the
4 bank.
5 So this smooth market is designed to do what
6 didn't happen in the late nineties and the early 2000s.
7 In other words, you saw the contribution rates drop and
8 then you saw them shoot back up.
9 One of the side comments that I would make is
10 CalPERS has gone to 15 years smoothing. They are out so
11 far on an actuarial limb, it isn't even funny. But it is
12 a great idea.
13 I'm not sure all actuaries will agree with me
14 on that. I really think they have done the right thing
15 on that particular issue. And the reason is, if you go
16 back and look at the market rate of return and use their
17 current methodology, what you will see is contribution
18 rates would have been relatively stable if they had been
19 using this methodology for the last 15 years. And that's
20 actually a great message for people to have.
21 The challenge, of course, will be as we get
22 into good investment return, do we really have the
23 stamina -- maybe that's not the right word -- do we have
24 the discipline to not grab some of those market rates of
25 returns faster than the CalPERS methodology will be

1 telling us we should be doing?
2 MR. ANGELO: And part of the irony is that when
3 the market was going up and CalPERS was using three-year
4 smoothing -- which is not very much smoothing -- even
5 then they second-guessed their own method, and actually
6 rather than simply let the method release those gains as
7 they normally would over three years, they accelerated
8 that as part of the benefit adoption process. Now,
9 though, CalPERS is definitely the thought leader:
10 15-year smoothing. John makes a good point.
11 Look at the graph of CalPERS contributions.
12 They go down, they hit zero, they come up. CalPERS ran
13 the study, if their current policies had always been in
14 effect, the rates would have gone like this (indicating),
15 just a little dip down. That's one piece of the
16 information.
17 The other question to ask is, would we have
18 been having these pension inequity issues if we did not
19 have the contribution holiday? So if the current
20 policies had always been in effect, yes, the
21 contributions would not have gone down. But to what
22 extent would that have changed the entire pension
23 conversation?
24 CHAIR PARSKY: I think we're going to call this
25 to a close now because we're a little bit over. I really

1 want to thank you all, all three of you very much.

2 I want to thank everyone for today.

3 We've given out a calendar, trying to determine

4 conflicts for the rest of the year. If you would fill

5 those out, we've only established two future meetings.

6 We'd like to do the rest of the year.

7 Thank you all very much for the day.

8 *(Proceedings concluded at 4:12 p.m.)*

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REPORTER'S CERTIFICATE

I hereby certify that the foregoing proceedings were duly reported by me at the time and place herein specified;

That the testimony of said witnesses was reported by me, a duly certified shorthand reporter and a disinterested person, and was thereafter transcribed into typewriting.

I further certify that I am not of counsel or attorney for either or any of the parties to said deposition, nor in any way interested in the outcome of the cause named in said caption.

IN WITNESS WHEREOF, I have hereunto set my hand on the 6th day of May 2007.

DANIEL P. FELDHAUS
California CSR #6949
Registered Diplomate Reporter
Certified Realtime Reporter