STATE OF CALIFORNIA

PUBLIC EMPLOYEE
POST-EMPLOYMENT BENEFITS COMMISSION

PUBLIC MEETING

Friday, July 27, 2007
10:07 a.m.

University of California, San Diego
Student Services Center, Multi-Purpose Room
(107 University Center) 9500 Gilman Drive
La Jolla, California

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

Daniel P. Feldhaus, C.S.R., Inc.
Certified Shorthand Reporters
8414 Yermo Way, Sacramento, California 95828
Telephone 916.682.9482 Fax 916.688.0723
FeldhausDepo@aol.com

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

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

LEONARD LEE LIPPS
California Teachers' Association

DAVE LOW
California School Employees Association

CURT PRINGLE
Mayor, City of Anaheim

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PEBC Staff Present

ANNE SHEEHAN
Executive Director

JAN BOEL
Staff Director

MARGIE RAMIREZ WALKER
Office Manager

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A P P E A R A N C E S

Public Testimony

Stan H. Coombs
Retirement Employees of San Diego County

James W. Feeley
San Diego County Retirement Board Member

Carol J. Halvorson
Retiree

Mary I. Helvie
Retired Public Employees Association

Ethel M. Larkins
California School Employees Association

Joan M. Raymond
American Federation of State, County and Municipal
Employees, Local 127

Stan Riggin
Retired Employees of San Diego County

George S. Shoemaker
California Retired County Association

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Presentations

Gail Beal
Senior Vice President
Keenan Associates

Judy Boyette
University of California

Pam Chapin
Senior Manager
Benefits and HR
California State University

A P P E A R A N C E S

Presentations
continued

Rod Crane
Director, Institutional Business Development
TIAA CREF

Ed Derman
Deputy CEO
California Teachers' Retirement System

Jack Ehnes
Chief Executive Officer
California Teachers' Retirement System

Nadine Franklin
Senior Member Benefits Coordinator
California Schools Employees Association

Jerilyn Harris
Vice President Board
California Teachers' Retirement System

Lakesha Harrison
President
American Federation of State, County and Municipal
Employees, Local 3299

Marty Hittelman
President
California Federation of Teachers

Mark Johnson
CalSTRS Actuary
Milliman

Dom Summa
Assistant Executive Director
California Teachers Association

Dave Walrath
Legislative Advocate
California Retired Teachers Association

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Table of Contents

Table of Contents

Table of Contents

--o0o--

BE IT REMEMBERED that on Friday, July 27, 2007, commencing at the hour of 10:07 a.m., at University of California, San Diego, 9500 Gilman Drive, La Jolla, California, before me, DANIEL P. FELDHAUS, CSR 6949, RDR, CRR, in the state of California, the following proceedings were held:

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(The following proceedings commenced with Mr. Pringle absent from the hearing room.)

CHAIR PARSKY: First of all, I want to welcome everyone in the audience to the fifth commission meeting. As I think all of you know, on behalf of all of the Commission members, we hold our hearings publicly. The public is welcome.

And I also want the thank the University of California. I have an especially close affiliation personally with the University of California, since I am a member of the Board of Regents and have served in that capacity, it's hard to believe, for a little over 11 years now. And I really appreciate, on behalf of all of the commission members, the hospitality of the University to our commission in connection with holding this hearing.

It's a beautiful campus. If those of you wonder how students can really study on a campus like this, several of us on the Regents also worry about that.

But the subject matter today is providing for the pension and health-care needs of California schools. It's appropriate, I think, for here. And we've asked experts on this subject to come and testify, and we will have that throughout the day.

Before, though, beginning I'd like to open each of our meetings, reminding the public of the purpose of our commission and making sure everyone understands kind of one basic tenet of the Commission.

First of all, the purpose of the Commission is to identify or quantify the amount of post-retirement pension and health-care liabilities that we believe people ought to be aware, with respect to California. And once the public is fully aware of these liabilities -- and at times, they're difficult to understand how you quantify them -- but I think one of the basic purposes of the Commission is to help educate the public on that subject. But to evaluate then various approaches for addressing the obligations that are not fully funded, to make sure that the promises that have been made to public employees are, in fact, met.

And both the Governor and the Legislature have made it clear, and I think there may have been some confusion in the public's mind about this; but they, as the policymakers of our state, have made it clear that promised pension and health-care benefits to existing employees and retirees will be met.

A number of the public participants in our commission hearings have started with concern, expressing concern, about the fact that these promises wouldn't be met. And the Governor and the Legislature have made it clear, as they established this commission, that they will meet these obligations. The question is, beginning to educate the public on what this means from a quantifiable standpoint, and how they can be met and financed in a prudent, fiscally responsible way. And so that's really underlying the whole work of this commission. And, as I said, hopefully by explaining that to the public, offering the public an opportunity to participate, we will advance at least the knowledge base of people, and then we can begin to talk about how we can assure that these obligations will actually be provided.

So that is by way of introduction.

We, at each of our hearings, we invite the public to come forward and offer commentary. And we try to do this in the most efficient way. And we have a number of speakers that will provide us their input.

So if no Commission member has anything they would like to add at this stage?

Anyone?

(No audible response)

CHAIR PARSKY: Then we'll just proceed to our -- and, staff, anything before we move to the public comment?

MS. SHEEHAN: No.

CHAIR PARSKY: Okay. I think this morning we have, at least so far, nine speakers. So if we can limit the commentary to between one and two minutes, we won't cut anyone off impolitely. But if you can do it efficiently, any written testimony or commentary you have the staff would welcome and we will incorporate it into our record.

So the first three speakers are Scott Plotkin, George Shoemaker, and followed by Joan Raymond.

So Scott Plotkin first.

Is Scott here?

(No audible response)

CHAIR PARSKY: Scott?

(No audible response)

CHAIR PARSKY: That's a mystery. That's a first. That's okay. Only in San Diego, maybe.

Well, then let's move on.

George Shoemaker, are you here?

Okay. George Shoemaker.

MR. SHOEMAKER: Good morning, Mr. Chairman, Commissioners, staff. Thank you for the opportunity to appear before you today and address you.

My name is George Shoemaker, and I was employed with the County of San Diego for over 20 years. I am immediate past president for the California Retired County Employees Association, representing over 100,000 members, and I'm also the first vice president for the Retired Employees of San Diego County, representing some 7,000 employees.

Mr. Kirkwood, our president, has appeared before you a couple times, and brought forth several of our retirement concerns such as double-digit increases in care for premiums, causing a problem for fixed income. He's also talked about the elimination and reduction of health-care programs that have been placed before you, and talked a little bit about GASB.

I would like to bring a couple of more concerns to you today. The first one is the changing conditions after employment, especially after retirees are forced to make irrevocable decisions affecting their life.

Once a retiree makes an irrevocable decision that will affect their future life, should the conditions upon which these decisions were made be allowed to change? If so, should the retiree be allowed to change their decision to go along with the changing conditions?

Seniors who thought they had financially provided for their retirement now face changes in their lifestyle because of these reductions and changes.

Secondly, it's a voice at the table. As these systems grow older, many systems are getting close to 50 percent retirees in the system. Should the retirees not have a larger voice on retirement boards to offset -- initially, as we know, it started out all actives, it's now retirees are almost 50 percent in some cases.

Also, the retirees have no voice at the provider's or the county's table, unless they accept where some union may or may not represent them.

(Mr. Pringle entered the meeting room.)

MR. SHOEMAKER: Should retirees not have a voice or something at the sponsor's table, especially if they're going to discuss things that affect their future and their life?

Third, I won't spend any time on it, was placing the balance of the financial budget on the backs of older retirees whose annual income is from twenty to twenty-five thousand. Reducing or eliminating these programs does that.

And finally, one that affects us all, is managing the health-care system. We all are concerned about this. And even though I am sure we can better control our own use of health service and save some cost, there needs to be more control in the overall program.

There has to be better solutions. And I believe this esteemed Commission, with its ability to assemble large amounts of data, will propose solutions to these issues. At least the retirees hope that you will.

Thank you.

CHAIR PARSKY: Thank you very much.

Joan Raymond, and then Mary Helvie, and then James Feeley.

Joan Raymond?

MS. RAYMOND: Good morning, Commissioners and staff. Thank you for allowing public comment today.

My name is Joan Raymond. I'm president of AFSCME, Local 127. We represent 2,000 City of San Diego blue-collar workers. Being concerned with pensions, maybe you've heard of the City of San Diego.

CHAIR PARSKY: We've heard of that City, yes.

MS. RAYMOND: The City of San Diego has been much talked about in the press. We were called the "Enron by the Sea" by the New York Times, and many other things since then.

But I'm here to tell you that we are on the road to recovery. And I hope to deflate the ongoing myths that are continuing to linger about our pension system.

Our workers have been part of the solution. We have always paid our share into the pension system. The San Diego deficit grew because popular and politically expedient projects, like the new baseball stadium, called PETCO Park, were given priority over making contributions into the pension system.

Now, a few top bureaucrats really did get gold-plated pensions, as they were called. But our average blue-collar worker for the City of San Diego, after 30 years, at the age of 62, gets a pension of $2,700 per month. That's based on our average pay of $20 an hour, in a city with some of the highest energy and housing costs in the nation.

Also, our city workers do not receive Social Security benefits, which has saved the City from paying 6½ percent of salaries into the Social Security system.

Now, since we were dubbed Enron by the Sea, the City has been making contributions. It's ramped up its contributions to the pension system.

In 2005, our blue-collar workers actually took a pay cut. And we earmarked the savings from that pay cut to pay down the pension liability. And the liability has been shrinking ever since.

We supported a ballot measure passed by the voters to reform the SDCERS board by bringing in outside financial experts and keeping workers and retirees represented on the board.

One of our own workers, a sanitation driver, named Franklin Lamberth, courageously agreed to run for the new board at a time when everyone was quitting out of fear of being indicted, and they were just afraid to get involved. But Franklin and the rest of the employees know how important it is to have employee representation on the board. He became the first blue-collar worker in the history of SDCERS to be elected to the pension board. And he has taken his fiduciary role very, very seriously. He would be here today except he's at another training on the pension. He's gone to many seminars and studies. So we think he's a very good example of why it is so important to have member trustees.

Also, the reformed board has done remarkably well in terms of investments. We're 80 percent funded now. We've had the highest investment performance in the nation -- in the top 4 percent in the nation.

San Diego is on the road to recovery, and it is partly because our workers are part of the solution, not part of the problem.

Thank you so much for your time this morning.

CHAIR PARSKY: Thank you very much.

We have now Mary Helvie, and then James Feeley, and then Ethel Larkins.

MS. HELVIE: Thank you for having me this morning. I'm giving you my comments as a retiree from CalPERS, and so mine are fairly personal.

My name is Mary Helvie. I am assistant area director of Area 8 of the Retired Public Employees Association and I'm also on their state legislative committee.

I worked for 32 years as a classified school employee, designated confidential by the collective bargaining agreements in law in 1976. I have no representation by any union as a confidential employee.

I retired at age 60 with my health coverage provided by my employer to age 65, which was bargained by our teachers and thus given to us.

At 65, I received a letter stating that my coverage would end the last day of July. The District offered no help when it came to helping me get new health coverage. San Diego Unified School District, I understand, does have a plan for retirees, but Chula Vista does not.

I thought I might be eligible for TRICARE for

Life through my ex-husband, a military retiree, to whom I was married for 40 years. I found out that I only was married to him 19 years, four months and 20 days while he was on act of duty. So consequently I get no Navy benefits whatsoever. I've raised his kids and took care of his home but no benefits.

I received a great deal of information from insurance companies. It was mind-boggling and very difficult for me, and I had to rely on a lot of my friends who already had coverage under Medicare in a supplemental plan. It was a scary time of my life, trying to decide what supplemental plan to get along with Medicare.

I did qualify for Medicare because my District's agreement with CalPERS included my paying into Social Security. And so I'm able to draw both CalPERS and Social Security. The teachers in our district at one time were not able to qualify for Medicare, but now they can work to earn this coverage.

My son is a police officer who may be able to retire in two years at 50, with 30 years of employment. He will lose his health coverage when he retires. The City of Chula Vista does not offer any health coverage for retired police officers, and he will have to pay for his own.

And finally, I took out a long -- also, he's not covered by Social Security. If he does get another job under Social Security, he can earn 40 quarters of coverage, but it will be reduced two-thirds because he's drawing CalPERS. So that, we're trying to work through RPEA to do away with this.

Also, I took out a long-term health-care policy through USAA at 62, when I began receiving Social Security.

I understand the premium will not change. My premium will not change; but I understand CalPERS has, which has resulted in an increase of pay for people who cannot maybe afford to pay for this coverage.

So far, I've been healthy and lucky. My income and health coverage appear to be sufficient. However, many people are struggling to make it. And I see RPEA members unable to attend our chapter meetings due to the fact they can't afford the $5 it costs to pay for their lunch.

I see many people in the emergency room where I volunteer come in. They have no health coverage, and the taxpayers are picking up their costs. So I understand that health coverage is a big, big thing right now.

Anyway, thank you for letting me be here and share my story.

CHAIR PARSKY: Thank you very much.

James Feeley.

MR. FEELEY: Good morning. And thank you for allowing me to speak this morning. I appreciate it.

My name is James Feeley. I'm a resident of San Diego County. I'm on the retirement board in San Diego County, and have been there for 21 years, both active employee and retired now. And it's easier to do things when you're active rather than retired as some of you will find out.

Anyway, I just want to speak to one item this morning. I know we are limited.

The retirement board in San Diego County, for 34 years, give or take, have provided health benefits for County retireds. We've done that at no cost to the taxpayer by using supplemental income over and above our actuarial assumption rate. We are very fortunate, we have good staff, we do make a lot of money by investments. And this money is used for health benefits and other ancillary benefits.

There's one little thing that causes problems with it. It's called a 401(h), which is an IRS method of getting money through to the retired health benefits. And it gets a little complicated. But all these plan sponsors -- which in our case is San Diego County -- can put money into that fund so that it's tax-free. And what I would like to do, if I could, is have you, ladies and gentlemen on the Commission, put it in there that the Legislature would change and allow retirement boards to be plan sponsors for ancillary benefits only. I'm not talking about the main thing. And this would be very beneficial. It would prevent having to give health benefits without being -- with being taxed. And the whole problem here is taxes.

We're on fixed incomes as retireds and that tax money that we have to pay on any money we give them, if they don't go through the 401(h), is more than they can have or take care of.

So what I would like is legislation to provide plan sponsorship for the retirement of the ‘37 -- we're in the '37 Act Counties, by the way, which I'm sure you're familiar with -- that the 20 counties in the '37 Act, the retirement boards could put money in 401(h) and keep it tax-free. Like I said, this money is investment money that's above the actuarial needs for the pension. So it's not going to hurt anybody there.

If you don't have it, you can't give it. And we're fortunate that we have it.

So thank you very much for listening.

CHAIR PARSKY: Thank you.

MR. COGAN: Mr. Chairman, can I ask a question of the witness?

CHAIR PARSKY: Yes.

DR. GHILARDUCCI: Yes, I was going to ask the same thing.

MR. COGAN: Just one question.

So the idea would be to create a level playing field between the, if you will, the employer contribution and the employee contribution to health benefits.

Now, we would need not only state legislation, but federal legislation as well?

MR. FEELEY: The federal legislation as it is, says that plan sponsors are the only ones who can put money in there.

MR. COGAN: Right.

MR. FEELEY: I believe that if the State, through the legislative process and the Governor, would allow retirement boards to be plan sponsors, I think it would work without it going to federal.

MR. COGAN: Okay.

DR. GHILARDUCCI: But right now, your retirees pay tax on the contributions that you make from your surplus?

MR. FEELEY: Some do and some don't.

The money that is provided by the retirement board to -- it's a certain tier, it's Tier A, they call it -- they must pay taxes on the situation but the money comes from the retirement board who aren't plan sponsors.

DR. GHILARDUCCI: Right, right.

MR. FEELEY: We have three tiers. Tier 1 and Tier 2 are provided by the County at this point. Using excess earnings, which I call them "supplemental earnings" -- "excess" doesn't sound too good -- and they are provided by the County. And the Tier 1's and Tier 2's at this point are tax-free. So we have two groups of people: One and one not.

DR. GHILARDUCCI: Okay.

MR. FEELEY: Does that answer the question?

CHAIR PARSKY: Yes.

Thank you very much for those suggestions. And you've touched on an area, namely recommendations relating to the tax code, both state and federal, that the Commission is going to be addressing. So it was very helpful. Thank you.

MR. FEELEY: Thank you.

CHAIR PARSKY: Ethel Larkins.

MS. LARKINS: Good morning, Board.

My name is Ethel Larkins. I'm from National City, California. I represent CSEA, California School

Employees Association. I'm the first vice president of my union and VP of my food service department. And I'd just like to speak to you on behalf of some of our almost 3,000 workers that are soon to be retiring. Food service workers, in particular, like I said, which is my division, which some don't have health care. We do have positions that have health care; but I also would like to say that we pay into the system. And we would like to not see the budget balanced on behalf of the workers.

We've been with CalPERS for years. As I said, we have retirees that have paid into the system that are now facing maybe cuts due to the budget. And like I said, I can't say it enough, that we don't want the budget balanced on behalf of the workers.

Thank you.

CHAIR PARSKY: Thank you.

We have three more speakers. We have Stan Coombs, we have Carol Halvorson, and Stan Riggin.

So two Stans. The first Stan.

MR. COOMBS: Thank you, Mr. Chairman, Members of the Commission. Thank you for the opportunity to speak.

I am Stan Coombs, a member of the board of directors of the Retired Employees of San Diego County, an organization aptly described by its name.

I've been retired for nine years after 30 years of County service. I'm fortunate. With my current benefits and savings, I enjoy reasonable financial security. But many retirees' benefits are meager.

The 2006 actuarial valuation and review published by an independent retirement system, the San Diego County Employees Retirement Association, reports the average county retiree's pension to be about $2,000 a month. Not exorbitant after decades of service.

That same report also shows that 41 percent, nearly half of the 12,000 retirees, receive less than $1,500 a month. Of that, they actually take home, of course, around a thousand dollars for which they contribute as much as 17 percent of their salary over their entire work employment period.

This, in one of the highest-cost housing areas in the nation, where health insurance and gasoline costs and who knows what else, are rising at double digits.

Against this backdrop, our County Board of Supervisors recently maneuvered a reduction in health benefits for many retirees -- some of those were just discussed by Mr. Feeley -- of about 25 percent, by creating a situation where those benefits would be taxable.

Even though those health benefits were not paid for by taxpayers but from excess earnings of the retirement fund, the fund, I've already indicated, was partially created by the contributions of the employees.

The excuse used by proponents of the reduction was that there can be no excess earnings when the fund has a deficit and that all excess earnings should be used to pay off the debt.

That sounds good, except that half the excess earnings they were so quick to grab for legitimately belong to the retirees who need the health benefits, and the debts of counties, principally caused by past failures to pay their contribution to the fund on a timely basis. As you can imagine, many retirees were outraged.

On another quick subject, let me note the current momentum toward defined contribution and away from defined benefit retirement systems and make three brief comments.

We support continuation of defined benefit plans. Properly managed, they're not expensive and much more likely to provide critically needed retirement benefits.

Secondly, pooled retirement funds so common to defined benefit plans provide a windfall for taxpayers and members alike. Industry-wide, we're told that about

70 percent of public retirement system costs are paid for by fund earnings, not taxpayers or members.

Without those professionally managed retirement funds, all of the retirement system costs would be transferred, of course, to members and taxpayers.

And thirdly, as much as we'd all like to think it isn't true, individuals, including individual public employees, typically don't manage their retirement investments very well. I'm reminded of AARP note publications frequently that talk about the very large proportion of the population of the nation that simply isn't adequately prepared for retirement.

Without professionally managed funds, hundreds of thousands of them will be without the resources needed to sustain. This has broad implications for the welfare of elderly retirees, for our social service and health support systems, and for our consumer-based economic system which depends on the resources of a rapidly aging population.

That concludes my remarks. Thank you for your attention. Please take these comments into consideration as you produce your report.

CHAIR PARSKY: Thank you very much.

Carol Halvorson.

MS. HALVORSON: Good morning.

First, a big welcome to the Commissioners and the distinguished guests. My name is Carol Halvorson. I am a retiree. I was fortunate to be able to continue my health care from my school district until age 65. This benefit was allowed because I had worked over 20 years and had reached the age of 55.

I took an early retirement because I have a disabled husband, and was the sole caretaker for my father. I am now living on minimal Social Security benefits and my PERS pension.

I'm very concerned for the current workers in the school districts regarding their health and retirement benefits. Many school districts are now hiding and hiring employees for slightly less than four hours to negate paying benefits. The basic health and pension benefits are crucial to retirees.

My fear for myself and those workers is that upon reaching 65, we will not be able to continue our forced Medicare payments, our HMO payments, and our long-term care payments, if we were able to qualify for that important safeguard.

Will there be enough pension left over to cover our basic needs?

Since my retirement, I have volunteered for my church in the capacity of ministry to the sick. This enables me to have contact with many individuals in nursing homes.

I see the difference in care levels and choices these individuals must choose for their care. Those who have some pension funds have many more choices and options.

Although these retirement issues may not affect you now, we know from statistics we are all living longer. So eventually, you will face the dilemma of how to survive on shrinking pensions and the monumental costs for medical services after working for 30 or 40 years.

Thank you for this opportunity to discuss some of the issues that concern the older workers of this century.

CHAIR PARSKY: Thank you very much.

And our final speaker is Stan Riggin.

MR. RIGGIN: Good morning. My name is Stan Riggin. I'm a member of the benefits committee of the Retired Employees of San Diego County. And I just wanted to share a few general observations with you.

I proudly spent a 35-year career in public service. When I ended my career, I was the deputy controller for San Diego County. One of my responsibilities was the County's retirement program.

I had ample opportunities to work in private industry or as a private CPA. But like many other dedicated individuals, I decided to spend my career in service to the public.

I knew I'd be paid less than in the private sector, but I was truly excited to think of serving the citizens of my county and looked forward to the longer-term potential if I remained in public service for a better and more secure retirement program, including the ability to obtain group retiree health coverage.

That's the way things were when I began my career. Unfortunately, public employees continue to receive very painful abuse by many politicians, the press, and even the citizenry in general, as somehow being leaches, feeding at the public trough, or being less than quality workers.

In recent years, that may have become a bit of a self-fulfilling attitude, as working for the government has seemed to be more of an employer-of-last-resort scenario as public service salaries and benefits have continued to erode.

The ability to attract and retain highly qualified workers has become a crisis in many areas, especially in trying to fill professional and even entry-level positions.

I made my decision to retire from the County several years ago based on a determination of the relatively fixed resources that I would have to rely on for the remainder of my life.

Now, the pronouncement of the Governmental Accounting Standards Board, or GASB, has very needlessly put that health benefit and even my ability to receive health care at all in jeopardy.

The San Diego Board of Supervisors, as you already heard, recently attempted to retroactively eliminate retiree health benefits for those already retired and also for those who retire in the future.

At a time when our nation is focused on the growing lack of affordable health-care coverage in our country as a whole, something I find, frankly, immoral in a wealthy, so-called civilized society such as ours, the GASB pronouncement will very likely result in many millions more of uninsured Americans nationwide. And that threatens not only the overall quality of life, of those impacted, but further jeopardizes their very lives and their ability to maintain the solvency when facing medical crises.

I urge your commission to truly seek viable solutions to the growing list of threats to our state and nation's health care, and to avoid knee-jerk reactions that will result in more retirees losing quality care --

quality health care.

Thank you very much.

CHAIR PARSKY: Thank you very much.

I want to thank all of the people who have come forward and made comments at each of our sessions.

Just a few comments that I would make administratively before we move to our first panel.

The next meeting of the commission will be in San Jose on August 23rd, and we will begin to have discussions about moving from information-gathering to proposed solutions at that time.

I'm going to try to work closely with the staff between now and then to see if we can't establish a framework for those kinds of discussions to take place, which will be done, obviously, in public session.

And I think as we -- the underlying purpose, again, of this Commission is to both identify the magnitude of the issue, and then see if we can't come up with, collectively, building a consensus among all of us as to some proposed solutions that we would recommend for policymakers and other decision-makers to put forward.

I think we will want to hear from representatives of the Governor's office and the Legislative Analyst's office, to have some thoughts about what might be able to be done legislatively. And I think we also want to hear a little bit more about the tax area, an area that we haven't had a lot of presentation about. And we may spend perhaps the morning session there doing that; and then try to move to start a discussion which we'll carry out in subsequent meetings of proposed solutions. So we can begin to define the kind of report that we can give in January.

Is that okay with the staff, if we ask you to do that?

MS. SHEEHAN: Yes.

CHAIR PARSKY: You can say no, if you want to.

I would also like to make just one other administrative announcement on a change in our hearing date in September, which will be in Los Angeles. We have moved that to Friday, September 21, and that will be also posted.

The only other administrative announcement, we will also need to consider our November date. I'm not going to identify who -- the audience can guess -- but one member of our commission will be on a honeymoon, and so we're going to try to -- you can submit all kinds of guesses if you want to. The only thing I will say is it's not me, so you can do what you'd like. But I think we're going to try to adjust the schedule slightly, and we'll have to come back to everyone to see if we can't accommodate all of us there.

MR. COGAN: Can't the member let us know where his honeymoon is going to be, and we can join him?

DR. GHILARDUCCI: Or her.

MR. COGAN: Or her.

CHAIR PARSKY: Well, at one point, I was thinking of giving Commissioners an opportunity to suggest locations for these hearings; but when one said "Hawaii" and places like that, I didn't think that would go over very well.

In any event, those are the administrative announcements that I have.

Anne, anything you'd like to add there?

MS. SHEEHAN: Yes, just a couple of things. Thanks, Gerry.

We will post the scheduled change, if it hasn't already been, so that people will know that that meeting has been moved.

Just a couple of things I wanted to share with the Commission. The staff has been busy on a number of projects. The major focus, obviously, for us is collecting the data from local government, school districts, special districts. We think it's going rather well. At this point, we've had responses from over 80 percent of the counties -- all of the big counties are in, so we're just busy tracking down some of the smaller counties -- just about 50 percent of the cities, 25 percent of the school districts, 13 percent of the special districts. That's probably going to be our biggest challenge. But we are working with them. And then just about 50 percent of the community colleges.

So we feel that we are good in terms of data collection now.

What I've asked the staff to do is go through and say, okay, how much of the population employees does that cover? And so the ones we're missing, are they really the small ones, and who do we need to go after?

As I mentioned at Burlingame and previous ones, and I know the Commission is aware, we are doing a number of case studies of cities, schools, counties, special districts, how they have dealt with some of their OPEB issues and some of their pension.

I think I sent out an e-mail to you all, just updating you all on who has agreed to be, as I would call them, our “guinea pigs” on these sorts of things.

And we're really going a little more in depth into each of those. So if anyone would like more information on that, we're reporting back in August some of our early findings on those.

And then also on the staff side, as you know, assuming our friends in Sacramento can get a budget completed, we did put some money in to do some consultants. We're going to retain some actuaries and others to help us in the final stage of the recommendations.

So really, on the administrative side, that is about it, unless anyone has any questions.

CHAIR PARSKY: Any questions?

(No audible response)

CHAIR PARSKY: Thank you very much, Anne.

Before we move to our panel, thoughts that any of the Commission members may have about process or about ways in which we can come up with a report that will be meaningful and that will really try to accomplish the underlying purposes that we mentioned?

I think that the current things to think about are obviously ways to articulate to the public of the magnitude of the problem, or the issues that we face, in a way that's understandable. With all due respect to actuaries that are in the audience, generally speaking, the public's eyes glaze over when actuaries start to talk. We've had a number of them, we will have more, and a number of them are very good friends of mine. So it's not meant to be that kind of criticism, but being able to come up with a way to articulate. And the idea of injecting case studies into this report is something I think the Commissioners ought to think about. Maybe even without necessarily identifying names, identify specific situations and articulate what a person has to go through as some of the members of the public have identified. I think it may have some merit here.

And then think a little bit about the kind of recommendations that would address what the policymakers in Sacramento can do -- Governor, legislators -- and what needs to be thought of by individual trustees and others that control the process away from Sacramento.

And in that connection, you may want to think about best practices.

What we've seen, what we've heard that would suggest that there are entities that have either engaged in or made changes to incorporate best practices, and making sure that we identify those practices, I think, is also something that we perhaps ought to think about.

And then this area of what changes in the taxation system, I think, is also important.

We can send some messages to Washington. It's a little bit far away, in terms of thinking that people will just listen to Californians and act. As my friend John Cogan knows, as well as anyone, sometimes messages that come from California aren't acted on immediately, and certainly not in a tax area. But I think it's important that we include that. And, frankly, changes that we can make in California -- as one of our members of the public mentioned, changes we can make in California that would automatically result in changes on the impact of existing law, that's an area that can be, I think, very helpful.

And then finally, I think it is important to begin to focus on policy actions that should be taken now as opposed to waiting for a crisis to happen. And here, I think, obviously we will want to give careful thought to that. But we've been told in the establishment of this Commission by policymakers that this is important. We were also told that the approach that had been taken in connection with a ballot initiative, we couldn't build consensus around. You can criticize it or not criticize it. That's really irrelevant. We couldn't build consensus around it.

So one of the underlying reasons for this Commission was to see if we couldn't build consensus; and if our decision-makers are of a mind to address this issue now, then it seems to me it behooves us to give them some recommendations and urge them to act now, as opposed to waiting until there is a crisis on hand and real priorities need to be shifted, taxes may need to be raised, other things may need to happen in order to do what they've said they're going to do, which is to honor the obligations that have been made to existing employees and retirees.

So these are the kinds of things I would urge the Commission members to think about as we move toward recommendations as opposed to information.

Any comments?

(No audible response)

CHAIR PARSKY: Okay, let's move to our first panel.

Jack, you're permitted to shift around in any order you want, Jack. That's perfectly okay. And I think your colleagues from STRS – well, that's very interesting, we have three STRS and one CalSTRS.

Now, Ed, do you have a special organization that you're involved in?

MR. DERMAN: I was the one who brought it to their attention. I was the one who got it changed.

CHAIR PARSKY: Thank you all very much for coming forward. I think maybe what we'll do is to hear from all of you, and then engage in some discussion questions.

So, Jack, if you want to lead us off, that would be fine.

MR. EHNES: Great. Thank you, Mr. Chair. And thank you for inviting us back for a second discussion, this time with a little more focus on the pension side than the health-care side. But we'll still have some comments today for you on health care as well. And I think we're hoping to speak with you for about –- I guess we're told for about 20, 25 minutes, and then engage in a dialogue with you.

Let me first start just by -- I assume you have our handout? Because you obviously can't see the screen. But I do want to walk through that with you and kind of amplify some of the comments that are on our slides as we go through today.

But let me first introduce, on my direct right here is Jerilyn Harris. And we really brought the leadership team here to be with you so it isn't just staff. And Jerilyn is our vice chair of our board, a retired teacher, but also has been a leader in education. So she's got a lot of vantage points to this issue to talk with you today.

On Jerilyn's right is Mark Johnson. And although he carries that label and baggage of being an actuary, I would tell you that Mark's been a very special resource for the CalSTRS board. And we've gone through many competitive bids over many years. And we choose

Milliman not because of Milliman, but because of Mark. He's been able to make the public translation of technical work to public. And I hope you'll judge that today for us, because I think Mark is very eloquent on the issues that we are facing. And Mark serves actually on the board of directors of Milliman, so he is a leader in the actuarial field as well.

And Ed -- a lot of you know Ed -- Ed is our deputy CEO, and really oversees a number of the parts of the organization, but particularly the actuarial part that we're so focused on today.

It sounds, Mr. Chairman, from your comments that you're in the last furlong before the homestretch. And I'm hoping we're not just talking at you --

CHAIR PARSKY: With the Del Mar racetrack at our back, that's a very appropriate comment.

MR. EHNES: Well, I am a racetrack person.

But I would say, I'm hoping we're not just talking at you, but leaving you some of the nuggets of information that does, in fact, leverage some conclusions.

I'm sure you're not surprised that when you started this in February, we're nervous. We're all nervous. We're not sure of the composition, how that works, the balance, the agenda, the conclusions, what it all means.

You've benefited from having some excellent staff that we know well. But I would say you've been very fair, as we listen to the speakers that come before you, many of which have difficult stories, you've done that with independence and objectivity. And we have a lot of confidence that the homestretch is meaningful and not just another commission report on a shelf.

This really does need to be an important point for California to define this area and what we are doing.

Let me start out here -- and not that, but kind of -- those are things you've seen before. Of course, they're kind of metrics around our system that were large -- large in the country, we're large in the world. But let me make a stronger point. I'm not sure I've heard this one said to you before. Our investment return is spectacular that we just issued our press release this week. It's 21 percent. It's not just one of the highest in the country, it's unusually large for such a large investor to have a return that size. Our real estate portfolio returned 32 percent and our private equity portfolio, 27 percent.

Not only have we become a major global player, but when we looked at interesting surveys of other investors that we're a partner with, we're viewed as a good business partner. That's critical to get in the top tier of funds and be successful at what we do.

The $25 billion that we gained over the last year is larger than most public pension plans in the entire country. Just that net change. In five years, we have doubled in size as a pension plan.

So even though that vision is out there 30, 40 years -- and Mark is going to share that vision -- you know being in a political environment and you have numbers like this, it's very difficult for people to maintain context.

I'm concerned that we don't get back into some dot-com period euphoria, and there's not the recognition of the way these markets work. And thankfully, yesterday, maybe it was a little sobering in checking behavior around this. But I do think possibly that's something you might consider and think about, is how you add context to the long-term financial portrayal of our pension plans as you think about that. How do policymakers working in a political environment come back when we have to be making sound economic decisions in what we do here every day?

We are transitioning from being bureaucratic old-time state agencies into modern, progressive financial services organizations.

And I challenge you to think about, have we laid the right organizational of the governance context in government for what we will be in ten years from now and twenty years from now? Step back from this short-term thinking about these returns. And these are large, complicated financial services, asset-management companies. Are we really ready, prepared to give us the tools to do that? And that's part of the dialogue that needs to go on, because we are definitely changing in culture and focus with our global strategies.

So with that start, let me just do a few more slides with you and then we'll go -- just, again, about CalSTRS. On the one hand, a lot of this must be mooshing together for you because we're talking one day about a city plan, a county plan, a CalPERS plan, a CalSTRS plan. So one of the things we do want to leave with you today is some of the unique attributes of this system being so large, and the fact that solutions could be different for different systems.

This Commission has served us well, and we have been issuing short policy reports as you've gone along. We issued one on health care and again today. We issued a report called “Teachers Count on Promised Pension Benefits” to look at the financing of our plan. But the one thing that's so critical for all of you again is that this plan has been tilted toward long service, given the nature of this profession, the longevity as you see is nearly 30 years of service. And the rewards that come from this benefit formula come through long service.

We do have a supplemental benefit plan as well that provides some additional security for our teachers, for that service that is in excess of a normal teaching year. So that does provide some added benefit.

But in a minute, as you see, the replacement ratios that teachers have, they're still, under any standard, modest.

The other thing to mention is, we are thinking differently about our business as well. I hope we are all leaving you with that impression, that we're not just here to defend the status quo. Even though we've been here since 1913 and the core benefit is solid, we are also thinking about other services and products.

Last week, we announced a new partnership with TIAA-CREF -- kind of unusual, frankly, for the public sector -- where together we'll be introducing financial services products throughout California because we do believe teachers have been abused by high-cost products over the years. And if we are going to talk about savings beyond the defined benefit plan, we want them in fair, good, low-cost products. And we don't think this market has served them well. So we are going to work very hard with TIAA-CREF to change this marketplace in the coming year.

Just on the benefit itself, you know, these two bullets fit together very tightly that we have on this slide. As any good financial planner will tell you -- and, boy, that wild card is retiree health care -- we think of numbers of 80 percent, 85 percent, some say even 90, I see in the literature, depending upon where that health-care benefit is.

That average replacement benefit for our members for new -- and you need to double-underline the word “new” there -- is 63 percent of income. So there's certainly a gap there so any concept that everyone's living on a cruise ship in retirement is quickly deflated by those kinds of statistics.

The side statistic to that, though, is really that's for new retirees. If we took a look at all of our retirees and kind of readjust that number, that drops down to about 53 percent replacement income. So that's really what a hard-working teacher expects out of our system.

So when you get letters or commentary or testimony here at the microphone about that purchasing-power program, that is absolutely critical to maintaining the stability of that replacement income. And I think rightfully so, teachers would like to see that number increase over time. That is probably the highest priority for our membership, is the maintenance of that purchasing power program. And with a 53 percent replacement ratio for the bulk of the membership, that 80 percent is very crucial.

What makes us different as a system? Well, you know, we do not get Social Security credit for while you're teaching with our system. So the safety-net issue is very vulnerable, it's porous for this membership. And that's a standout finding. And the implications of that, for as we think about improving the system, that guides a lot in what we do.

But the next bullet on there is really the one I'll come back to when I close that I guess we have reached a conclusion with our board, we need to think about and talk about differently.

I think over the years, the fact that the Legislature has determined the contribution rates has served us reasonably well in the charts that we have in that policy paper that we gave you, you see actually the employer rates have not changed since the eighties for us. But the markets have been more volatile. And we have to figure out, how do we make economic decisions in a political context to this system? And the fact is, if we're going to rely on a legislative body to have that financial tool on a close to -- soon a $200-billion operation, you are guaranteed that you are going to make decisions too late in the game, and they would become more expensive.

And again, a distinguishing characteristic about CalSTRS -- not uniquely but certainly many other systems rely on the governing body to make those adjustments. And I think our board expects that those have to be done within prudent parameters, certainly.

But the fact that the system is not more elastic around this issue is a stand-out issue for us for our success in the future. So I hope, again, you'll highlight that bullet. And the fact, again, that our system is based on local employers determining the health benefit as well.

And just finally for my comments, you know, I don't know that we've done a good job as a pension system. We spend our time educating our members, doing actually a spectacular job with the investment portfolio. And I'm not sure the public understands our connection to the rest of California.

We issued, again, a policy paper on this, along with CalPERS, by commissioning a study with Sac State.

These numbers are huge. If you relate them to other sectors of the California economy, the spin-off economic benefit of those $6 billion of annual benefits rivals other significant economic sectors in the California economy.

Now, that's a common ripple, economic model that you see universities do; but I think it is, as you can certainly look at methodology here and debate the numbers a bit; but it says big things, not just about the impact to our membership, but the impact to jobs in the state, to the tax revenues to the State, and particularly in some of the non-urban areas that we often forget in that economic dialogue.

So I'm hoping, again, that we tell that message a little stronger than we have in the past about this plan.

So let me turn now to Mark Johnson, as I said, our consulting actuary for CalSTRS.

Mark, I'll give you this.

MR. JOHNSON: Thank you very much. And I appreciate the opportunity to come and glaze your eyes.

CHAIR PARSKY: We'll try to stay alert throughout your presentation.

MR. PRINGLE: I move for a recess.

MR. JOHNSON: Let's quickly get into some numbers. You're used to actuaries talking about numbers. The slide you have in front of you is a pie chart. And a couple things I wanted to point out. As was mentioned by one of the public commentators, investments are, by and large, the vast majority of the funding of a system like CalSTRS. And you'll see over the last 20-plus years, investments have produced about 63 percent of the revenue. Members and employers, about 15 percent each, and the State has put in about 8 percent of the total over that period.

Now, this kind of pie chart would be changing depending upon the time frame you look at it. If you looked at it, you know, in 2000, right before the market’s decline, that investment percentage might have been closer to 70 percent, and so forth. So it is something that changes.

As Jack pointed out, the employer contribution and the State contribution are set in statute.

Now, just to give you a little bit of perspective, in 1913 teachers were asked to contribute $12 a year to this plan. And they received all their past service credit. So all the credit they've had as teaching before 1913 was trying to be financed by $12 a year. The schools didn't put in anything, and the State offered 5 percent of the inheritance tax.

I submit to you that starting in 1913, this plan was in the hole, okay. And it used those types of contributions until 1930s, 1940s. Then the State started to pay. But it was called pay-as-you-go. They would contribute just what was required to make the benefit payments at that time.

It wasn't until 1972, almost 60 years after the program started, when the Legislature put in a program to fund in advance. And by "fund in advance," what I mean is the contributions going in this year should be paying for the benefits being earned by the teachers this year, not last year.

Social Security, for example, is more or less pay-as-you-go. So money that's coming out of my check for Social Security is paying for my relative's benefit next month, okay.

What we want to try to do here is to even things out. The taxpayers of the state of California, in their current taxes, ought to be paying for the benefits earned by the teachers this year. And that's the goal of advanced funding. That was put into place for CalSTRS in 1972.

In 1998, the program became what I call fully funded. In other words, the contributions going in were paying all for just the benefits that were being earned in that year. That was 1998.

The other thing I want to point out here is that unlike most other retirement systems -- and Jack alluded to this -- all of the contributions are defined by the statute. The most customary role of the actuary to a retirement board is to make a recommendation on what the employers ought to contribute next year. That's not the case here. And I'll talk a little bit more about that as I get a few slides later.

The State contributes 2.017 percent of salaries. That's declined. In 1998 it would drop to that level. So if you do a calculation, you say, well, since 1998 the State has saved $3 billion -- in other words, $3 billion less has gone in during this time period because the contribution went down. The contribution went down in 1998, that was a key point. That was when a benefit improvement went into place, and at the same time, contributions were reduced. This is because this was the first year in which, since 1913, we had a surplus -- an actuarial surplus, not meaning that there was money to say is a dividend. But we were, now, past the point of just paying for benefits that were currently being earned. We had more than enough to pay for just the benefits currently being earned.

Employer contributions, 8¼ percent of pay, unchanged since 1990.

Member contributions, 8 percent of pay, unchanged since 1972.

And then there's an additional 2½ percent of state contributions that goes into a reserve fund to pay for the 80 percent purchasing power.

By the way, the basic CalSTRS program does have an automatic cost-of-living adjustment. It's somewhat antiquated in that it's called a simple, 2 percent simple. Instead of being compounded, it's 2 percent of your original benefit. So over time, you're not really -- you can't keep up with 2 percent inflation, let me put it that way, all right. You're going to fall behind on 2 percent inflation.

This, as Jack mentioned, is a key element for the security. The benefits are not rich. And if we can't keep the purchasing power level for teachers on this modest benefit, I think we're really doing a disservice. So this is a key element of the benefit structure.

Let me talk a little bit about the 2006 valuation. Anytime somebody says $20 billion unfunded, it raises your level of alertness, so to speak. I would point out several things. All of the methods, assumptions, calculations that we've performed in these valuations have been reviewed by competitors from time to time. And that's a point I wanted to make that didn't get in the slide. But on a defined benefit program, it's my belief that from time to time, retirement systems ought to hire my competitor to come in and look over my shoulder. And we support that wholeheartedly. And when CalSTRS did it several years ago, and you totally cooperate -- and this has become more common. Actuaries are used to doing it because nobody likes to have somebody look over your shoulder, obviously. But for the benefit of, I think, the taxpayers, you ought to be very supportive of this.

Some actuary can have just a small glitch in their computer program that can compound over decades, and then all of a sudden somebody can look at it and say, "Wow, they said we were in good shape and we're not." So that's one of the things I wanted to mention.

Now, for CalSTRS, our role is not to recommend a contribution rate. On the other hand, it's to say: Can the contributions in the statute work out? Is that enough money to finance all of these benefits, to pay for the benefits that are being earned this year, and if we're behind, to pay for the benefits that have been earned in previous years?

The unfunded obligation as of the last

valuation that was performed was $19.6 billion. That's 87 percent funded. That sounds pretty good. And it's not bad. In fact, there was a gain this last year from investments, from salaries being not quite as high of increases as they were in the past. And we expected the unfunded obligations to be $22 billion, and it turned out to be 19.6. So, again, you've got to recognize, in a system like this, there are gains and losses that go each time you do a valuation.

Even though the contributions that are coming in exceed the cost of benefits being earned this year, there's not enough difference between the total revenue and what it cost for the benefits being earned this year to amortize that unfunded obligation. It doesn't work.

Somebody asked me earlier this morning: Well, okay, the board's policy is to try to have that amortized over 30 years. Well, how long is it? Well, it's infinite. It just doesn’t work.

And, again, the Board's policy is, again, not to set a contribution but to just see if it works. And 30 years is kind of a standard time frame. It's the length of a career, for example. So it's just to see if the contributions coming in can finance the benefits. And they cannot.

The primary reason is lower returns, and to a certain extent, some -- I'm going to tell you how it got so high -- to a certain extent, there's some salary losses as well. But for the most part, these are the returns for three years in a row and, obviously, represented huge losses.

And when an actuary is talking about a loss, it's anything less than the assumed rate of return.

In this case, we're assuming that over a long period of time, a portfolio such as CalSTRS will earn 8 percent per year. If you earn 7.9, it sounds all right, that's a loss to the actuary.

So here, in 2000-2001, you're 17 percent behind what we thought it would be. In 2001-2002, you know, you're 14 percent behind what we thought it would be.

Well, 2002-2003, you finally get up above zero? Well, no, you're still 4½ percent behind what we expected to be.

So all of that is compounding these losses. It was just unprecedented. And that's what put CalSTRS in the hole that it's in.

To a lesser extent, during this same time frame, towards the end of it, we had experienced losses due to salaries. In other words, the salaries of the average teacher increased higher than we expected.

Those types of demographic gains and losses go both ways. It just so happened that during this time frame there were losses. And what happens is that you'll get, due to the collective bargaining and so forth, you don't always get the same increase every year. Sometimes the district may say, "Well, we can't have any salary increase for the next couple years, but then later you catch up.” So those types of things vary by district.

But it's kind of a double whammy here. At the same time we had these investment losses, we had losses due to salaries.

I'd like to point out that the benefit enhancements in the late 1990s did not cause this shortfall. As I mentioned before, it was the first really substantial benefit enhancement in decades.

And after the benefits were enhanced, the system still had a surplus, okay. And we've done some calculations to just put a perspective on this. During those three poor investment years, if the market had returned about 6.7 percent, we still would have been 100 percent funded.

And if we factor out those salary increases right at the end, the unusual salary increases, if the market had just returned under 3 percent, we still would have been, you know, 100 percent funded.

And to put it even lower, to say, “Well, we don't need to be 100 percent funded. We just need to finance this over 30 years.” All you would have needed was a market return of 5.4 average for those three years. And, obviously, we were way negative.

So can it happen? Yes.

And we looked at, several years ago, right at the end we got in this big deep hole, and the question was, when we got here from investments, can we invest our way out of it? And, of course, everybody would like to think we could. This is just down, and we're at the bottom of the wave, and we're going to go back up and do it. Well, we did a stochastic analysis to determine the chance of investing your way out of this with a reasonable portfolio; it was less than 6 percent.

So it can happen, you can invest your way out of it. But the chance of doing it is very, very small. And we've recommended, as Jack has mentioned to the board, to try to deal with a different way to finance this, so that we're not just stuck in a hole that gets deeper and deeper, because this is a perfect situation of pay-me-now or pay-me-later.

If the actuary is right, and the assumptions turn out to deliver experience year by year that's reasonable, if you're in the hole now and you're not contributing enough to get yourself out of the hole, the hole gets deeper and deeper.

So with that, I'm going to turn it back to Jerilyn.

MR. PRINGLE: Mr. Chairman, I have a couple question's.

CHAIR PARSKY: Sure.

MR. PRINGLE: Could I ask them now or would it be better to do it later?

CHAIR PARSKY: Well, I thought we would finish the panel.

MR. PRINGLE: Okay.

CHAIR PARSKY: If you think it's really ripe, you can do it, but I thought maybe we'll finish the panel and come back around. So let's keep the thoughts.

By the way, that was not a glazed-over presentation. That was very astute.

MR. JOHNSON: Thank you.

MR. PRINGLE: For some of us.

Because I –- really, part of my glazed-over presentation is how to make sure charts on pages 4 and 5 are the same, since I don't understand where hose dollars are coming from and the level of contribution from both the employer, the employee, the State, and such. So if I can reserve that question then.

CHAIR PARSKY: Yes, if you can hold that and reserve it.

MR. PRINGLE: I can reserve it until later, but that's what I want to ask.

CHAIR PARSKY: Okay, so you'll be ready?

MR. JOHNSON: Yes.

CHAIR PARSKY: Okay, Mark.

Who will be next, Jack?

MR. EHNES: Jerilyn Harris, our vice-chair.

MS. HARRIS: Thank you, Commissions, staff, our wonderful Anne Sheehan who is in service with us so beautifully on the CalSTRS board, and members of the audience.

I'm currently vice-chair of the Teachers Retirement Board, chair of the leg. committee and the appeals committee and vice-chair of benefits and services, former chair of the Commission on Teacher Credentialing, and from three governors I've had seven total appointments, governors' appointments. But the thing I'm proud of is I'm a classroom teacher. I've spent my life teaching. I want you to know, there are 800,000 of us out here between retirees and those who are actively teaching. And we're real people. And everything you say and do affects us.

I've spent 27 years teaching, five years in Beverly Hills, 22 in Ukiah. Interesting, when I left teaching in Beverly Hills, very pregnant, I knew that I was going to be a housewife the rest of my life. And we moved up to wine country and got a house we loved. And the next thing I knew, well, I was just going to sub, and then, gee, we could use a little extra money, and now I'm looking back on a career. I've been retired since 2002. And I'm very grateful to CalSTRS for making that possible.

Just to put a personal at the start, when I was at UCLA -- I'm a UCLA graduate -- I was recruited by Beverly Hills –- with a degree in biology. And I remember saying to my dad, "Gee, I wonder what I ought to do with my life?" Because I wanted to go into medicine. My father said, "Jerilyn Anne, you get yourself a teaching credential, because then if your husband ever leaves you, then you can keep a roof over your head." And I hated him for it.

32 years later, when my husband left, I could keep a roof over my head. So I thank my dad.

I want you to know a little bit about what these numbers and what these statistics mean in the life of real teachers, because we are not living a rich life out here. 64 percent of our retirees are women. Our average age is 72. I'm not there yet, but it's coming a lot faster than I would like to accept it.

Our median monthly income is $2,400 a month. And when you think of what it is like for someone to live on that in the state of California, it's certainly not rich.

60 percent of us are unmarried. We may not have started out that way, but 60 percent of us are currently unmarried.

And we are expected to live approximately 27 years after we retire.

Our CalSTRS retirees, the educators in California have fewer safety nets than most other retirees. We depend on our defined benefit from CalSTRS heavily. It's our primary source of retirement. Most of us do not have any Social Security coming. Some who do have been encouraged to go into teaching mid-career. And I did serve as chair of the CTC for a long time as we tried to recruit. Those teachers who are being encouraged to enter teaching mid-career often find that they will lose much of their Social Security that they garnered elsewhere because they've chosen to go into teaching.

I have some friends that are very angry with me who went into teaching with my encouragement then found out recently about the kind of penalties that they incurred for doing it.

Teachers' retiree health-care benefits are determined by each school district, not by CalSTRS, not by CalPERS.

We are unlikely to have employer-subsidized or paid health care after we reach age 65. 62 percent of us receive no financial assistance for health care from our employers. That number is growing.

We do a survey every three years because we have predicated our actuarial comfort zone on providing a somewhat adequate retirement on whether or not we have health care. And most of us don't have it. So we're basing this whole premise for retirees on a falsehood.

Only 1 percent of employers offer retired employees the same level of health benefit as their working employees.

I'm still working for my school district, even though I retired five years ago to pay for my health care. But other personal, I blew out a knee two years ago that I was told should be operated on right away. I have a few more months until I'm eligible for Medicare, at which time I'm going to get the knee fixed.

86 percent of our employers who employ 62 percent of the school employees provide no retiree payment for health benefits once we reach 65. That's an increase from 78 percent in 2003. So you can see the

direction that health care is going for the educators of the state.

Many of these people were your teachers. So we're going to take a look at a couple of teachers, and they are not atypical.

The first is Jay Klopenstein, who lives in Carlsbad, not far from here. He's 68 years old. He has 39 years in teaching, mostly at the high school level. Since he retired in 2000, he has worked two jobs. He buys his insurance for his son. Just to pay the medical bills for his family he works at two jobs. Even while he was teaching he faced financial challenges due to health-care costs. He not only has high expenses for a son that is only covered to a small degree, but he had a daughter who was hospitalized with meningitis, and his health plan only paid 20 percent of the cost of that hospitalization.

He had to work extra jobs in addition to teaching to avoid bankruptcy. Now, he continues to work to pay the $10,000-a-year insurance coverage that his school district is allowing him to purchase. And that district is actually being generous because many of them say: Sorry about that. You might have put in 30, 40 years with us, but you're no longer working for us.

Jay's health plan has a cap of $30,000 for his son's hospitalization. But the cost just for his son runs from $60,000 to $90,000 a year. So he doesn't see an end to his working in his, quote, “golden years,” unquote.

Anne Anderson has worked for 35 years as an elementary teacher. She lives in -- excuse me, it's Anne H., excuse me, she lives in Anderson in Shasta County.

I'm nervous. I've talked in front of people my whole life, but this means an awful lot to me.

She retired in 1998 after 35 years of teaching in the Cascade Union Elementary School District. She is 69 years old. She receives a $2,500-a-month CalSTRS pension. She pays for her health insurance. Her school district dropped financial contributions for health coverage when she turned 65. She pays another $280 every three months for Medicare Part A.

She has serious medical conditions, peripheral neuropathy, high cholesterol, and diabetes. Without insurance, medication would cost Anne more than $725 a month.

Anne's husband retired from teaching in 1989. He was dropped from her insurance when she turned 65. He has a Medicare Part D prescription plan that helps to cover the cost of his medication for non-Hodgkin’s lymphoma.

He needs serious dental work, but they can't afford it. After two of his crowns fell off, he went to Mexico to get cheap replacements, but they didn't work. So he resigned himself to a smile with two big gaps.

Lack of employer-paid insurance has placed a financial burden on Anne and her husband. They took out a second mortgage and used their credit cards to meet their payments from month to month.

The Teachers Retirement Board is well aware that the health-care problems face retired educators, and they are drastically important. We now pay Medicare hospital Part A premiums for retirees who don't qualify based on their own work.

Last summer, CalSTRS established the Public Education Benefits Task Force to help determine how CalSTRS can assist our members and employers with health-care problems. I serve on that task force with representatives from the State Treasurer's office, the Department of Finance, the insurance industry, the teacher unions, state employee unions, school districts, community college, CalPERS, and CalSTRS. The task force is developing recommendations on how CalSTRS can address this critical shortage.

We expect some sort of final recommendations early in the fall. We are still meeting. And we ask you to understand we are real, we are hurting, and we need your help.

CHAIR PARSKY: Thank you.

MS. HARRIS: Ed Derman will take the next section.

MR. DERMAN: Thanks, Jerilyn.

I just want to spend a few minutes talking a little bit about where we stand in terms of the future, both as far as the pension program is concerned and health care.

Speaking on the pension side, you know, Jack made references to our 21 percent investment return this past year. And you know, we've had similar -- we've had very high returns the last four years. And I guess it's sort of indicative of the impact that those three bad years that Mark talked about, that even with those really high returns -- and 21 percent is the highest return we've had in over 20 years -- that even with that, it's still not enough to retire the $20 billion unfunded liability that we have over any time period. I mean, it had that big of an impact on us.

So, you know, that sort of reflects the notion of whether or not we can invest our way out of it. It seems unlikely. So it is something that the Board continues to address.

And in looking at this for the last year, they sort of -- in the course of a number of meetings, the board came down and adopted a number of principles that they've asked the staff to utilize in terms of developing a specific strategy. And it involves sort of three major principles. One is, the information that we've given you sort of identifies the fact that the benefits that are provided by CalSTRS, while they are good benefits -- I mean, they're certainly not terrible benefits -- they are not rich benefits. And as we've said, this is really the only source of ongoing income that our members receive because they don't get Social Security benefits. So it was very important to the board to sustain the existing benefit structure and not reduce those benefits further.

Secondly, you know, in response to what we've seen over the last several years about the impact on health care for retirees and the reduced support from employers for retiree health care, they wanted to see what possibilities existed for CalSTRS to assist members, retired members, in improving the affordability of health care in their retirement. We do it now in terms of for those people who didn't qualify for Medicare hospitalization. But the board wanted to see what more could be done with that. And that's a big part of what the task force, that Jerilyn just referred to, is looking at. So they wanted to see how we could help that out.

And then the third critical piece is something that Jack and Mark both talked about, in terms of having some limited flexibility for the board to set contribution rates.

As Mark said, that when you rely upon a fixed contribution rate, you have to go back to the Legislature to adjust, you know, you're always going to be a little bit behind just because of the timing of these events. And if you don't make those changes, then you just get deeper and deeper in the hole. So the Board felt that it was important to have some flexibility.

It recognizes that having that flexibility will have an impact on school budgets and on employees. And so we are spending the time working with our stakeholders and the Legislature to get them to understand what the issue is with our funding of our pension and what the implications are of having some adjustments that -- some limited authority of the board to adjust it. But the important thing that what we're looking at, in terms of what the board is looking at is having that limited authority.

Unlike other pension systems where the board can set it at anything from zero to whatever in order to fund the benefit, I think the board recognizes that there has to be some limits to that. For a couple of -- and limits in two ways. One is that there's an absolute limit, that the contribution rate doesn't drop below a certain amount, it doesn't go above a certain amount without having some further legislative action.

But the other consideration is that whatever those increases or decreases are, they occur gradually, so that the employers have some opportunity to adjust their budgets to reflect that; and that there be enough warning and enough notice so that they can make the necessary changes they're budgeting.

And even with that, you know, with that kind of authority, we can address and fully -- and appropriately manage the pension issues that we're dealing with as far as the funding is concerned. But that's a key issue for them.

As far as the health-care strategies, you know, it's important we do provide the Part A coverage for those people who don't qualify on their own. We have a very well-funded program to do that. And while from a GASB perspective it may not come across this way, in reality we've actually got more than enough assets sort of identified for this program to fund those liabilities.

So unlike many other health-care programs, this one actually is very well funded. And there are opportunities perhaps to extend the benefit to some other people who don't currently qualify under the program, but still are not going to get Medicare coverage when they ultimately retire.

So this one is something that the Board is very supportive of, of continuing that very important program because it saves those affected employees, you know, $300 or more a month in not having to pay that premium themselves.

And then the final issue, in terms of their strategy, is evaluating the recommendations that the task force ultimately gives the Board in terms of how to address the health-care issues that the retirees in particular are facing. And after the task force makes that recommendation to the board, the board will have an opportunity to evaluate that and see how it wants to go from there.

So the board is very much involved in both the pension and the health-care side because based on the mission of the system to secure the financial future, both of those are very critical pieces of a secure financial future for our teachers.

Finally, before turning it back to Jack to wrap up, I just sort of want to talk a little bit just to sort of summarize the promises that CalSTRS has made and the promises that it has been able to keep.

Number one, to provide a benefit to members that is fair, that is appropriate for the level and the type and the length of the service that they provide. It is biased more towards longevity, which is reflective of the kind of occupations that teachers have where they tend to work a very long time. But they're also very committed to a well-managed fund. And even though we do have a shortfall at the current time, it is in much better shape than it had been historically. And the board is very committed to trying to address those situations, and not funding benefits that they can't support. Even though they would like to be able to increase benefits, they recognize that they have the responsibility of managing the fund well.

And related to that is adopting a plan that's responsible, that is sensitive to the impacts on members and employers and the State, to try to meet the projected shortfall that currently exists because they recognize that even though we have been wildly successful in our investments, that it wouldn't be prudent to assume that that kind of investment returns will continue indefinitely.

So let me turn it over to Jack to sort of give you a little wrap-up before we turn it over for some questions.

MR. EHNES: Thank you. A few quick points.

One, to circle back, if I could, to the contribution issue, if you have that little policy brochure we provided along with your slides on page 3, it graphically shows, quite starkly, the 17-year history of these contribution trends, and just how they've never changed, obviously, for the employer and the employee; and it shows the decreasing contribution from the State side that Mark went through. So that kind of shows you what's been funding this plan over these 17 years.

Just a final comment, I guess, is just around expectations a little bit and where we can help and where you might go with your findings in the end. I think I'm on pretty good ground here assuming you don't have a $10 billion pot of money that you've been keeping here that you're going to put on the table at the end of your period and fund retiree health care, but that you have to look otherwise for -- and I'm assuming that we have that -- the wonderful word –– an alignment of interests here that you're trying to make us more successful.

And I guess if I could respectfully challenge the chairman here to picture running that private equity fund under the public sector environment that we work under and the decision structures and compensation structures, and the purchasing structures; and, you know, that should give you some sense to produce a 21 percent return under the burden we carry. If you add up the assets of the top three pension plans here in California, we're getting dangerously close to a half trillion. So I'm hoping you're going to -- you need to provide the vision here.

Gosh, if it's close to a half trillion dollars in 2007 and we're trying to make some guidance here for the State and think through 20 years of how are we going to position an asset-management environment like this going forward? How would we create that phrase that we always like to use, a business-friendly climate for us to make our decisions on? Because we are running big financial services operations every day. And the pressure is on because the sunshine is much tougher on us than the private-equity world in terms of our decision-making. So we've got to do that in a business climate to manage close to a half trillion dollars in aggregate already going forward.

So please do consider looking at those tools that would make us more successful, such as we've said several times today purposely to you around looking at the financial tools that can keep the system elastic, responsive to economic changes in the environment, and take us away from being in a political football environment for a financial services world.

So that's our comments for you. And we'll be here as long as you need us.

CHAIR PARSKY: Thank you very much.

Let me just start off and then we'll turn it to Commission Members.

First of all, I really appreciate, as I'm sure do all Commission members, this kind of presentation.

I hope that your fear has been alleviated a little in terms of what our objective is, and that is, although we can't make decisions, we've been asked by the leadership -- political leadership in this state -- the Governor and the legislative leaders -- to come forward with some recommendations to give comfort to public employees -- in this case, public teachers -- that benefits that have been promised to them will be met, and create an environment where we can continue to attract quality people to public employment.

When you start with that, then the proposition, then the first step, as we said, was to try to understand some of the facts that are important. In that connection, you're certainly to be congratulated about the performance in this year, and perhaps the performance over the last three or four years. But I think your presentation highlighted the problems that can be created by one or two or three years where, perhaps out of your control, you have the most professionally well-run investment program, but the markets don't allow you, if you will, to meet the kinds of returns that you have currently achieved.

Therefore, I think you've indicated that these high returns have not resulted in your changing your estimate or what you guide to, which is still an 8 percent return.

Is that correct?

MR. EHNES: Correct.

MR. JOHNSON: Correct.

CHAIR PARSKY: That would suggest that, along with your comment about not believing you can invest your way out of this, you're not proposing to change the 8 percent.

Is that right?

MR. EHNES: That's correct, that's correct.

CHAIR PARSKY: And that's, in part, inherent in that is a belief that over time, that's an appropriate level of return to be anticipating; right?

MR. JOHNSON: That's correct.

CHAIR PARSKY: And, therefore, let's put a little bit more meat on -- assuming for the moment -- and I think it's important for the public to understand that these returns, many people have come to us as individuals and said, "Why are you worrying about an issue that should just go away? Because these returns have been so high. And even if you assume 12 or 13 percent returns, you don't have an issue," at least a number of people are saying.

From what you all are saying, is that's not a prudent way to go about looking at this problem.

Is that right?

MR. EHNES: Correct.

MR. JOHNSON: I'd like to respond to that.

The actuaries' assumption isn't going to produce revenue, okay. I mean, we could assume 12 percent, and there would be no unfunded obligation in the valuation. But that means that you have to earn -- average 12 percent a year from here on out. And that's not going to -- no prudent investor would be able to tell you that that's really likely to happen.

I've got to tell you that in the nineties, boards would come to me and say, "Johnson, what are you thinking? Only 8 percent? I mean, we were earning double-digit for the last eight years. What are you thinking?"

And I said, "Well, wait, hang on.”

And now recently, until just the last year or two, people said, "Johnson, what are you thinking? 8 percent, there's no way you're going to earn 8 percent."

So it is a long-term horizon. And we make projections for a teacher that's hired, that's going to go out 75 years or more.

Obviously, the liability is more weighted to those who are already retired or close to it. But when you look at a long time frame, I think you've got to be more prudent, and consider the implications of being too aggressive on your assumption just to make it look like you're in sync.

CHAIR PARSKY: Thank you.

MR. EHNES: The other thing is I think we need to get out of this black-and-white drama around the funding of these plans, because we are talking with you about some reasonable modulation of what that revenue would look like. And all of our graphs and charts have long history spans to them that we present them. But we're often combated with, frankly, opportunistic presentations that begin in the year 2000. And we all know sound business judgment can't be made around that kind of data in this presentation.

So it's one thing to say, “Yes, there needs to be a revenue adjustment.” But how much and the context of it is often lost in this public debate.

And again, I guess I encourage you to give that kind of sound, reasonable interpretation to all these stories you've heard today, so that people get in the right level of concern. Whether it's cautiously guarded or whether people reach other draconian conclusions is greatly determined by this context that we've set in place here; and the dialogue hasn't been reasonably defined.

CHAIR PARSKY: One final question before I turn it over, and that is, I took out of the comments about the decline in the State contribution level, and your comment about this is not a problem that has been created by increased benefits. I just want to make sure you clarify that.

What is your point of view on the movement down in the State contribution?

MR. JOHNSON: I think the graph showed that if the State contribution had not declined from 1998, there would be $3 billion more in the fund, plus earnings on that $3 billion. So let's say there's four or five billion extra. The unfunded obligation would be

$15 billion instead of almost 20.

I think Ed can talk more specifically to it, but there was a bit of a trade-off in 1998, when we were faced with a system that was well-funded. And a combination of lessening the obligation of the State with improving the long-term benefit for the teachers was doable, taking a snapshot at that point in time. And the Legislature saw fit to make these changes at that point in time. But this is not a snapshot. This is a movie. And things change.

And my point was that had we had even just, call it a poor three years, we still would have been 100 percent funded. We had a disastrous three years.

And fortunately, I think, for the teachers in the state of California, this is a safety net. This wasn't a defined contribution plan where teachers about ready to retire in 2003 would have saw a third of their money disappear; okay. So that's the safety-net issue here.

And it is a tough issue. I mean, when you're faced with providing a guarantee and you're trying to invest the money as best you can, if you have a bad year, things don't look as good as they did the year before. On the other hand, there are systems, plans that are contributing much less than they did 20 years ago because of the investment return. And you may get some testimony on that as well, where the actuary is making a recommendation on contributions. Sometimes those contributions go down.

CHAIR PARSKY: Ed?

MR. DERMAN: Just to follow up on what Mark said, just to give you some sense.

When the decisions are being made from the board about supporting these changes, I mean, just to give you a sense of the concern the Board had about the prudence of those benefit enhancements, we went through a lot of the analysis with the board about looking at different scenarios of investment returns in the future and what impact those reduced returns might have if we didn't improve these benefits and then the investment returns went down, where would we be? And quite honestly, we never contemplated -- I don't think anybody contemplated a market like this.

And so, you know, based on the analysis that we had done, we had said we think this is a prudent thing to do. It's okay to increase the benefits. Even if the markets go down to some degree, we can still maintain a well-funded, adequately funded, fully funded system. And, unfortunately, the returns were much worse.

CHAIR PARSKY: Curt?

MR. PRINGLE: If I could just ask a couple of these questions.

I'm trying to -- again, the chart on page 3, when you talk about the financing of the benefits. So I see the contribution level really from the members and the employers, and then this 4.3 now to 2 percent State contribution reflects the 8 percent overall funding to the plan.

Is that correct?

MR. JOHNSON: Are you talking about this pie chart?

MR. PRINGLE: I'm talking about that chart, not what Jack is showing you.

MR. JOHNSON: Okay, yes, let me explain the difference.

The percentages that we show on the following pages are a percentage of salaries.

MR. PRINGLE: Right, I get it.

MR. JOHNSON: So the members are putting in 8 percent of their salary.

What I'm saying on the pie chart is that represents 15 percent of the revenue we expect for that year. In fact, this is historical.

MR. PRINGLE: So with the growth in there, the individual wage, because it matches a percentage, basically, that has remained relatively constant and to the level of contribution --

MR. JOHNSON: This is an average over twenty-some years.

Just to give you a context, the total salaries of the teachers in the state of California is about $25 billion. 8 percent above that is about $2 billion. What we're saying is that $2 billion represents about 15 percent of the total revenue we expect in one year. So that's why we are saying, the members are contributing 15 percent of the total. It's 8 percent of their pay, but it's 15 percent of the total.

MR. PRINGLE: And with that then, that is set by statute?

MR. JOHNSON: Yes, sir.

MR. PRINGLE: The employer's contribution level, the employee's contribution level, as well as the State contribution; right?

MR. JOHNSON: Yes, sir.

MR. PRINGLE: So when this State contribution went down 2 percent, or went down by 50 percent, there was a trade-off as a part of that, is that --

MR. JOHNSON: Well, I won't speak for the Legislature.

What I'm saying is that at the same time that

that happened, there was a benefit enhancement. And the net result of the increased cost of the benefit enhancement and the decrease in the State contribution was the system was still in a positive funding position.

MR. PRINGLE: Right, just because of the years of positive investment growth?

MR. JOHNSON: That's correct.

MR. PRINGLE: I see.

CHAIR PARSKY: Just pause on that for one second, because coming out of that occurrence, what recommendation would you give to our legislative leaders as a result of that experience?

MR. JOHNSON: That's a good question.

I think looking back, clearly, there were a lot of reasons -- and I'm not a policy maker, but there were a lot of reasons --

CHAIR PARSKY: You can go ahead and pretend for a while.

MR. JOHNSON: There were a lot of reasons to make the benefit changes that were made.

One of the things that would happen is we were trying to provide an incentive for the teachers to stay in the classroom longer.

Now, that has other benefits that you don't see by the cost of the retirement system. That may save the district from training and so on and so forth.

So the Legislature, for probably a number of reasons, went ahead and thought that these benefit enhancements were prudent. So I'm not saying anything to dissuade you from that.

One of the things, from looking in hindsight, is that after the benefit enhancement was made and after the contribution from the State was decreased, there was a very small amount of the contribution that was left over beyond what the cost for the benefits were in that particular year. In other words, with 20/20 hindsight, you say, well, there wasn't enough left over to pay for an unfunded liability that might come in, in the future. And that's with 20/20 hindsight.

But even today, of a total contribution coming in of about 8 -- revenue from members, employers in the state of about 18 or so percent of pay, over 16 percent of that is used to pay for the benefits of the current year. So what's left over was not enough to finance the unfunded liability.

And one of the things you see is, well, we're 87 percent funded. But even though that's fairly-well funded, there's not enough revenue above what the annual cost is for contributions to amortize that.

MR. PRINGLE: And if I could ask then, in '98, when that legislative action took place, would it have been defined that the system was fully funded at that time?

MR. JOHNSON: Yes.

MR. PRINGLE: So the concept that it was fully funded, and that I believe that when the State contribution was originally established to establish the CalSTRS program, it was a State contribution until the plan was fully funded.

MR. JOHNSON: Yes.

MR. PRINGLE: So you're making a State contribution, therefore, legitimately without adding additional program -- I mean, the State had the ability because of their prior or early-on established position on making a State contribution, that that could have gone down to zero at that time?

MR. DERMAN: Yes, although under the way it had been structured, it would have gone down over a very long period of time. And, instead, the Legislature enacted a bill that brought it down right way. So that was part of the trade-off.

And that a gradual reduction is reflected in that $3 billion savings. It's $3 billion on top of what they have gotten, anyway.

MR. PRINGLE: And if I could, Ed, ask you a question. How many of the 734,000 members, be they retirees or active, are state employees?

MR. DERMAN: Oh, very few.

MR. PRINGLE: And so that is kind of the weird relationship to me here, too, in terms of what is the statutory benefit presently in place for STRS?

MR. DERMAN: It's equal to 2 percent of per-year service of final compensation at age 60. So --

MR. PRINGLE: So 2 percent at 60, and that is established by the State?

MR. DERMAN: By the statute.

MR. PRINGLE: The contribution limits are established by the State.

MR. DERMAN: Correct.

MR. PRINGLE: And is it also established by the State that local districts cannot participate in Social Security if they wish?

MR. DERMAN: That was actually a decision -- well, it's sort of established by federal law that allowed the state or occupation groups to decide whether to participate. It was actually the teachers who decided in the fifties not to join Social Security.

MR. PRINGLE: So to change that, individual districts could not, even though they are not the employer, they could not allow for that --

MR. DERMAN: Correct.

MR. PRINGLE: -- individually within their district?

MR. DERMAN: It would have to be a statewide change.

MR. PRINGLE: It would have to be a state change?

MR. DERMAN: Yes.

MR. PRINGLE: Thank you.

CHAIR PARSKY: John?

MR. COGAN: Jack, you made me real nervous when you started out. The CEO of a very well-run and very successful pension fund says -- I think I've got the quote here right -- "Yeah, I'm a racetrack guy."

MR. EHNES: Well said.

MR. COGAN: You may have a tough time living that one down.

MR. EHNES: That’s a good point.

MR. COGAN: In any event, I have a question for you, I guess, Jack and Mark and Ed and Jerilyn -- anybody who wants to. It follows on Gerry's question. And it gets to this issue of governance. It seems to me that when I think of a defined benefit plan and a defined contribution plan, I can see the benefits of the DB plans.

They have one failing, it seems like, in the public sector especially, and that is there's a systematic tendency for underfunding. And the story that is told about CalPERS and the story that you told about STRS, is maybe a good story about how we end up with systematically underfunded pension plans in the public sector. When the returns are high, the fund becomes a little bit overfunded. 110 percent of the liabilities are covered by the assets. The Legislature steps in, cuts the contribution rate, and maybe raises the benefit rates. And then as night follows day and the returns fall as they have in 2001, 2002, 2003, we find the pension fund underfunded and in trouble. Okay, and it's a very, very common occurrence across all legislative bodies.

So when I think of our job down the road to recommend how we handle especially the health-care problem, but pensions as well, I wonder how we can develop governance procedures that would help protect the long run of these funds, the long-run solvency of these funds from the short-run tendencies of our political system?

One way, obviously, to do that is to separate the decision-making with respect to the fund from the legislative body. I want you to get your thoughts, if I could, on that. But even short of that kind of global recommendation, are there accounting devices, are there institutional rules that have worked in the past that would better protect the pension funds and health-care benefit funds, should we set them up, from this tendency to grant benefits, not necessarily because the benefit levels are inadequate or recruitment is inadequate, but because the money is there, and to cut contribution rates simply because that money is perceived at the moment not to be needed?

So, maybe, Jack, you can --

MR. EHNES: I can start, and Mark, if you would -– we didn’t rehearse this, of course. But Mark has some experience outside California in his consulting practice, where I think key decision-makers were reluctant to embrace sound economic judgment, and so he might reflect on that.

But your caricature of the clash of the short-term versus our long-term vision and needs is very real for sure. And this chart -- you were right there when you said this, well, maybe there was a need to set a different glide path for that contribution rate. But instead of an incremental light path, people jumped for the ring immediately and say, "It's precipitous decision-making.” And we do need to have those financial tools in place to allow us to be more elastic but in a continuous fashion, and not in these abrupt changes that go on in what we're doing.

Having said that, I don't want to paint the picture too bleakly. I worry a little -- I think we're in a reasonable situation, but there's definitely room for improvement. The governance of the system itself, especially –- you know, I'm very proud of our governance because it does reflect a blend of policymakers that come from governor's appointment of public representatives, teachers that are elected by the teachers -- we need those on the board -- retired teachers, and then constitutionally elected officers. It creates an interesting blend of perspectives. Where elsewhere in the country, as we speak right now, people are debating other public pension governance structures that might have sole-trustee governance structures over hundred-billion-dollar-asset plans. And people also wonder is that also a sound model, even though that can lead to very nimble decision-making to your point, much more CEO-like structure, that also has terrible weaknesses, I think, given the fact, ultimately -- we can't be so divorced from that political structure because ultimately, the State is the plan sponsor. Or they're the settlor of the trust, going back to the legal start of this whole thing. So in the end, they pay the bill if something goes wrong.

Mark, you've got so much good experience around that conflict, around economics versus other tainting decision factors that get in.

MR. JOHNSON: Well, I think the governance of CalSTRS is set up in a very good manner. Let me give you an example of one that was a total disaster, and that was the state of Oregon. And there were 12 members on the board, nine of which were -- 12 board members, nine of which were in the plan. And certain aspects of the program were such that they are decisions that could be made by the board that would affect the benefits.

So as you had a good return, for example, they could credit some extra money to members' accounts. And it totally got out of hand. They received advice from the Attorney General's office. They were also in the plan. There were lawsuits filed -- the judges were in the plan.

I’m not saying everything was corrupt, but what I'm saying is there was a system set up that was designed, in my opinion, to fail. And we helped the Legislature several years ago totally revamp that plan, where the trustees are set up so they're not making those types of decisions, there is private participation on the retirement board, and so on and so forth. They have outside legal counsel, which they were never allowed to have before. That's kind of the extreme case.

I think for CalSTRS, there are very few instances, if any, where the board itself has an effect on the benefit level of a member. That's good from your standpoint, and that should stay that way.

I think what Jack was alluding to in terms of the contribution is it would be helpful for the Board to be able to assist in smoothing out these really, I'd say outlying events, such as the returns of 2000 to 2003.

CHAIR PARSKY: Just to follow that for one second in terms of given the fact that you wouldn't recommend allowing a board to impact benefits that they might benefit from. How would you address the concerns about the Legislature making the kind of decision that they did, which was to reduce their contributions at a point in time? How would you deal with that?

MR. JOHNSON: Well, the amount of information that the Legislature receives on a bill is enormous, as I'm sure you're aware.

I think that there ought to be -- and there is now -- a requirement for an actuarial impact statement. And we do those. I mean, any -- some of the smaller ones, we don't. The actuary and the staff at CalSTRS does. But the larger ones, we take a look at. And we think that's important as well.

But I think if you had gone back to 1998 -- and even if I had done a study that said, "You know what? I'm just going to throw out a number here, there's a 5 percent chance that this whole thing is all going to blow up," what would the Legislature have done? I mean, would they have said, “Okay, there's a 5 percent chance we're not going to pass this benefit," or “There's a 5 percent chance, we'll take it”?

CHAIR PARSKY: Focus on the contributions side. What, for instance, would you say about changing the ability of the Legislature to reduce contributions at a different level? Instead of 100 percent, maybe it was --

MR. JOHNSON: Well, in my opinion, there ought to be a trigger in the Act which says that if we do get into a situation like we're in now, that temporarily we're going to increase the contribution.

If it's an automatic trigger, or whether the board pulls the trigger, so to speak, there ought to be some way to gradually reverse course. And that's not possible now without walking down, you know, to the Capitol and lobbying to try to get -- you know, that's --

MR. COGAN: Would it be symmetric, Mark? Would you have a trigger that's symmetric?

MR. JOHNSON: Absolutely, yes. Because that addresses your issue of becoming overfunded, and then wanting to spend it.

MR. COGAN: Right, right. That makes it fair.

MR. EHNES: Yes, absolutely.

MR. JOHNSON: And the nomenclature is leapfrog and ratchet. Okay, ratchet is: Once you go up in a benefit, you're not going down.

MR. COGAN: Right.

MR. JOHNSON: And leapfrog is: They've got it, we want it. And when you've got different systems in one state, that's what's going to happen. So in order to prevent that, I think you're absolutely right --

MR. PRINGLE: But isn't one of the issues here really that the State Legislature is controlling the contribution limit, and the employer is actually that local school district? So that local school district may wish to address some of the fiscal stability issues, and others may have other priorities, therefore, I think part of your whole challenge is making sure you set a floor, if there is a legislative floor of contribution, but then allow for that floor to be increased, be it by that local school board of the employer contribution, because there are, believe it or not, school districts at times that may wish to put a higher priority in moving some of those dollars in that year forward into a higher contribution. And if they were given that ability to, they would be able to contemplate that, as opposed to they don't have to contemplate that today. They put in X-percent established by the Legislature, even if there may be some within that school board that says, "You know, that 5 percent risk that was presented, I'm going to make sure we protect ourselves from that.”

MR. JOHNSON: Well, let me tell you where you're going to end up if you do that. You're going to have, what, 1,100 school districts in the program. Eventually, we're going to have to do it -- instead of doing an valuation on one system, we're going to have to do an evaluation on 1,100 employers. It's going to be like CalPERS, different employer contribution rates for all the districts.

And then what happens when some districts don't put in the extra monies, others do, investments go up, and one district now is 140 percent funded, the other is 80 percent funded. They're going to want a different benefit. I think it falls apart in a system like this if you start to cut up the pie into 1,100 pieces.

MR. PRINGLE: So CalPERS demonstrates where it's falling apart?

MR. JOHNSON: No. What I’m saying is that --

MR. PRINGLE: Let me get it clarified. Because there’s multiple benefit schemes under the CalPERS deal, and I just want to see if that is a definition of where it's gone bad. I'd really like to hear that a little more clearly.

MR. JOHNSON: I'm not saying that the CalPERS system for municipalities, and so on and so forth, in the state -- I'm not saying that's bad. It's complicated, yes, but it's not, per se, bad.

What I'm saying is that for the teachers in the system to have their benefits determined on how the funding did because of the decision that was made, most likely through collective bargaining, to make an extra contribution, is going to eventually turn into some inequities across the state for the teachers.

CHAIR PARSKY: Teresa?

DR. GHILARDUCCI: I have three short questions, and I think a rather longer one.

But now I just want to be clear, because I thought I was, in your presentation, but it's gotten unclear.

Are you recommending that this Commission recommend that the CalSTRS Board has the authority to set contributions?

MR. EHNES: Yes.

MR. JOHNSON: Yes.

DR. GHILARDUCCI: But you've qualified that. You've said “limited authority.“

MR. JOHNSON: Yes.

DR. GHILARDUCCI: Could somebody spell that out and the rationale for it?

MR. DERMAN: Sure.

MR. EHNES: And this is, of course, the balance between what would give us total flexibility and what needs to be realistic in an environment where the plan sponsor is a settlor of the trust.

Ed, would you --

DR. GHILARDUCCI: If you could separate that. What is really ideal for a good financial system, which a pension fund ultimately is? And then nuance it by what you think the political reality is. I just want to know what the ideal is.

MR. DERMAN: I would think that the ideal is that the board can set the contribution rate at whatever level is necessary to amortize the cost of the plan over whatever period of time is appropriate.

DR. GHILARDUCCI: Okay, so why not just stop there?

MR. DERMAN: Well, because we do recognize that we need the approval -- it's not a board decision to make that. And I think we're trying to be sensitive to the impacts of that proposal.

DR. GHILARDUCCI: Okay.

MR. DERMAN: So what we have proposed to the board is that there be a floor, the contributions can't drop below a certain amount of money.

DR. GHILARDUCCI: What? Normal cost or --

MR. DERMAN: Actually, it's below the rates that they currently are, to be honest with you. But that is essentially the normal cost.

DR. GHILARDUCCI: Okay.

MR. DERMAN: So I think it's fair that at the very least -- I think Mark would agree, at the very least, you ought to contribute what the normal cost of the plan is. You shouldn't go below that.

And then put a cap -- and there's no specific number on the cap – but there should be some limit, so it doesn't go above that.

DR. GHILARDUCCI: What would be the rationale for a cap? To decide that it's not too high or --

MR. DERMAN: Just so I think –- it’s one of those things -- you know, if for no other reason, that there's some governor on so that if things got bad enough that it ended up having to go above that cap, the Legislature ought to be involved in the decision of how it wants to address that.

DR. GHILARDUCCI: No, but if you're that really underfunded and if you have to fund over a period of time --

MR. DERMAN: Again, it's a reflection of the realities of the world we live in.

DR. GHILARDUCCI: Okay, well, what cap would you put then?

MR. DERMAN: We looked at a cap, and we looked at for the board a year ago, there was a cap of 13 percent for the employer. That may not be the number that would be necessary now, but that's a reasonable number. And I think it was 3¼ percent, I believe it was, or 3½ percent for the State, and 8½ percent for the employee.

DR. GHILARDUCCI: Okay, okay.

MR. DERMAN: Then the other key piece of limiting it is that it go up, in terms of what we identified for the board a year ago, is that it go up a half a percent a year, so we don't have these large whip-saws that a lot of other pension plans have gone through, so that there's a gradual amount.

DR. GHILARDUCCI: So you amortize the contributions in some ways?

MR. DERMAN: Right. And also, so it's more sensitive to the budgetary implications to the employer.

DR. GHILARDUCCI: Sure, sure.

MR. DERMAN: But, again, it's a reflection of -- it's a balance between the needs of the fund versus the needs of the people involved.

DR. GHILARDUCCI: Well, as I said before, a pension fund has to be legitimate to the workers who are paying in to it, to the employers that has serviced a lot of taxpayers, and to the State, who is also contributing as well, and to the voters.

The second question is, let's get clear about why the teachers are not in Social Security, just to clear that up. The federal government allowed some states to exempt their employees -- not all states -- and the State allowed the teachers to decide at one point. So ultimately, I just want to be clear, it is the State Legislature that decides whether or not their state employees are in or out; right?

MR. DERMAN: Well, the way historically -- the way it was, when Social Security was created, all the public employees were out.

DR. GHILARDUCCI: Right.

MR. DERMAN: And the Congress allowed the states to let them in. And it was a vote made by the teachers. And it may have been pursuant to state law, I honestly don't know. But it was a vote made by the teachers that they said, "We've got a plan that's well in advance of Social Security."

DR. GHILARDUCCI: Okay, but you don't have to have a vote of the teachers to put them into Social Security?

MR. DERMAN: That may well be the case. That may well be the case, yes.

DR. GHILARDUCCI: That's actually just too technical.

The bigger question is, should teachers and school employees be in Social Security? And that would seem to be reasonable.

MR. DERMAN: Well, yes, we've looked at that because there's been proposals in the past for Congress to mandate everybody in Social Security. And what we've found was -- and Mark has done this analysis for us -- is the cost to the employer and the employee would be so enormous, having them pay 6.2 percent, that -- that, you know, that would have been hugely costly to the school districts for the kind of benefit they would get out of that.

So, yes, they could. And even if we reduced our benefit to compensate for what they would have gotten under Social Security, it would have still cost substantially more than what they're paying, anyway.

DR. GHILARDUCCI: And when was that study done?

MR. JOHNSON: We've done it several times. We'll certainly get a copy of that for you.

DR. GHILARDUCCI: Yes, great.

MR. JOHNSON: In 25 words or less, the reason that that's true is you go back to this pie chart, and Social Security doesn't have two-thirds --

DR. GHILARDUCCI: Right, coming from investment.

MR. JOHNSON: -- coming from investments.

DR. GHILARDUCCI: Right, right.

MR. JOHNSON: So once you're going to say, "Okay, where are we going to put this 6-plus percent from the employee and 6-plus percent from the employer" --

DR. GHILARDUCCI: Sure.

MR. JOHNSON: -- are you going to have it in Social Security or are you going to earn 8 percent interest?

MR. EHNES: And the portfolio clearly creates restrictions in their ability to -- I mean, if someone had the financial willingness to fund us there with those extra dollars, we, of course, would amplify that much more than a Social Security benefit would ever do with a 32 percent --

CHAIR PARSKY: The Social Security IOU's didn't earn quite 25 percent.

MR. EHNES: So that's a hurdle they just could never overcome in the cost of money.

DR. GHILARDUCCI: Okay, the third question is, maybe to anticipate your task force recommendations or just if somebody would just talk about this, you were talking -- because I'm not clear, either -- you know, you were talking about the inequities in retiree health coverage by these many 1,100 school districts.

Are you going to propose a state law that all school districts provide retiree health?

MS. HARRIS: I could try to answer that, but I don't know just what the group is going to propose yet.

However, one thing that I want was extremely interesting -- and had I known it at the time I decided to go into teaching, it might well have had an impact on where I chose to teach.

DR. GHILARDUCCI: Yes.

MS. HARRIS: All districts -- and Ed, correct me if this is an incorrect statistic -- with 500 teachers or less, have no health benefit, no lifetime health benefit. It is only the larger districts that -- or the very, very wealthy districts that are offering that lifetime health.

But the number of teachers who are in those large districts -- i.e., LAUSD, whatever -- really, it is the cornerstone of what a lot of policy has been over many years. So here, we're looking at a future teacher shortage -- we already have one in many areas, particularly rural areas. I come from a rural, and certainly our chair, Dana, from Weed is from a rural, rural area.

What's going to happen to the state of California in those rural areas as it becomes known that this very, very important component of a public-service career is going to be missing in small areas?

DR. GHILARDUCCI: One more question. I know that the public is going to want to know the answer to this question, and I would suppose it's the Commission's responsibility to answer it, which is, what does "86 percent funded" mean? What does something less than underfunded mean in this way? We know it was a Social Security debate, that what it meant is that by 2042 the system would only have enough money coming in to pay three-fourths of benefits.

So that, of course, it was lost that that was only under a certain set of assumptions, the intermediate scenario. But if CalSTRS went along 86 percent funded, at what point would the system not have enough money to pay 100 percent benefits? And under what circumstances?

MR. JOHNSON: That's really generations out there. It's not an issue of CalSTRS running out of money.

DR. GHILARDUCCI: Right.

MR. JOHNSON: It's a situation of pay-me-now or pay-me-later.

I mean, at some point -- I have not calculated when that is, but it would be very, very long in the future.

But if I look at Table 14 -- you don't have it in front of you -- of the actuarial valuation, just to cite that, if no changes are made to the contribution levels, and all future experience emerges just like we're assuming, including 8 percent return, that $19.6 billion unfunded obligation will grow in 30 years to $158 billion.

DR. GHILARDUCCI: Okay.

MR. JOHNSON: So in order to fix the problem now, assuming that we earn 8 percent, all the other demographic assumptions turn out to be true, it costs several percentage of salary.

DR. GHILARDUCCI: That's it?

MR. JOHNSON: Yes.

DR. GHILARDUCCI: Like 2? What is it?

MR. JOHNSON: No, it was 3.3.

DR. GHILARDUCCI: 3.3 percent of salary?

MR. JOHNSON: Correct.

MR. EHNES: But, Mark, I think we want to make that point that you often tell that board, which is you could be 91 percent unfunded and still unable to amortize your obligation.

MR. JOHNSON: Right.

DR. GHILARDUCCI: Without any boost, right.

MR. EHNES: And those numbers could sound great but you need that extra detail from anyone, is can we amortize?

DR. GHILARDUCCI: Got it.

MR. EHNES: If not, there is a point of problem out there.

DR. GHILARDUCCI: Okay.

CHAIR PARSKY: What year -- how many years for the 158 to have --

MR. JOHNSON: 30 years.

CHAIR PARSKY: 30 years? But that doesn't mean in 30 years you will be 158 billion short?

DR. GHILARDUCCI: It does.

MR. JOHNSON: It does if there are no changes in the contribution, and all the future experience emerges as we're assuming, that's where you're going to be.

DR. GHILARDUCCI: So you need to increase contributions?

MR. EHNES: Somewhat. Soon.

MR. COGAN: And it is true, the sooner you do it, the less the taxpayer is on the hook for and the less the employee has to contribute towards maintaining that retirement.

MR. EHNES: And that's a cost-of-money issue that we're consumed with. But it's hard to get a short-term environment to appreciate that.

MR. COGAN: Right.

MR. PRINGLE: Unless the taxpayer is on the hook for it. I saw that there was a contribution made from the State. So those state taxpayer dollars that is presently a part of this system; right? And that is unique to CalSTRS, we're going back to that 2 percent and 4 percent -- there is not a similar type of contribution from the State for non-state employees, from the State's General Fund to CalPERS; is that correct?

MR. DERMAN: Well, the amount of money that the State provides under the revenue limits for the school districts that are under Prop. 98 is adjusted as the CalPERS contribution changes. But it's all under the amount of money that the State has to pay the schools, anyway. So the color of that money might be different, but…

MR. PRINGLE: So you're saying because this is Prop. 98 money --

MR. DERMAN: Well, the State contribution is not. But I was talking about –- we were talking about CalPERS, when there's a change in the State's -- in the employer's contribution to CalPERS, the State's -- the revenue limit that any individual district gets also changes.

But CalSTRS is a different world.

MR. PRINGLE: So for the employees of CalPERS, there's not a state equivalent contribution --

MR. DERMAN: No, not a direct contribution.

MR. PRINGLE: -- unless they are the employer? Unless the State is the employer?

MR. DERMAN: No. What I'm saying is for a given school district, like San Diego Unified, for example, that has a revenue limit, their revenue limit will change in response to a change in the CalPERS contribution rate.

MR. PRINGLE: You're making it way too complicated. I was making a simple point. The employees of the city, my -- as the mayor of Anaheim, I don't get a benefit --

MR. DERMAN: You are correct.

MR. PRINGLE: -- from the State General Fund to pay 2 percent of my CalPERS costs.

MR. DERMAN: You’re correct.

MR. PRINGLE: I was trying to make it nice without being mean.

CHAIR PARSKY: Stay nice. It's very important.

MR. PRINGLE: That’s what I work on.

CHAIR PARSKY: Lee?

MR. LIPPS: I'm practicing my patience.

CHAIR PARSKY: That’s good.

MS. CONWAY: You're the one that's getting married? Is that why you said that?

CHAIR PARSKY: We're not supposed to reveal that.

MR. LIPPS: That is precisely what I meant.

MS. CONWAY: That's what I was alluding to, Mr. Chairman. I apologize.

MR. PARSKY: It’s okay.

MR. LIPPS: Actually, I have several questions. But, again, I don't want to keep people from lunch.

First of all, Teresa, with respect to your question on Social Security, let me offer the model that happened in 1985 when it became required for teachers hired after April 1st, 1986, to have to pay a contribution into Medicare of about a percent and a half. That only applied to teachers, towards new hires in a district after April 1st, 1986; and the school district had to make a matching contribution.

For those teachers that were already hired in that district, two things had to happen for them to be able to qualify for Medicare at age 65. The first is that that there had to be a districtwide election, a Medicare election, where the teachers as a group voted whether or not their individuals could opt in.

If there was no election held -- and, Dom, correct me if I'm wrong -- as I recall, it had to be a joint decision between the school district management and the teachers in the district because they were both going to have to contribute for this earlier group of retirees. If the district did not hold an election, then none of the teachers who worked in that district prior to April 1st, 1986, were allowed to contribute to Medicare and thus wouldn't qualify for it.

If you held the election, then it was an individual opt-in –– you know, it was an opt-in by individual teachers. You could decide that you wanted to be able to qualify for Medicare at age 65, and a lot of that would be determined by the level of benefit that the district you were working in offered, whether it was lifetime or not, whether or not you thought you were going to stay in the district, or if you were going to qualify for Medicare by virtue of being, you know, through your spouse, by virtue of being married, as I recall, for ten years or more.

So the astounding thing is that there were any number of districts where the election was never held. I don't recall the exact number of districts -- I'm sorry, Dom?

MR. SUMMA: I have that for my testimony.

MR. LIPPS: Dom has that for his testimony later today.

But my guess is that should some sort of legislation change and teachers be able to go into Social Security, a similar model, it might be followed -- or at least contemplated. I just wanted to clarify that part.

The original question, Chairman Parsky, that you asked about, the actuarial assumptions, I would like to revisit that with Mark.

Mark, over about the last 20 years -- and I know that CalSTRS has used an 8 percent assumption rate on investment return.

Over the last 20 years, how many years has that, Mark, not been met? Just sort of ballpark.

MR. JOHNSON: You know, I don't have that. If

I had to make a wild guess, I'd say probably a third.

MR. LIPPS: Three?

MR. JOHNSON: A third.

MR. LIPPS: About a third? Okay.

We've heard testimony at our last meeting of the actuarial assumption by CalPERS of 7¾ percent. But there's no quibbling between that and 8 percent, that there was only a 50-50 chance, probably chance of hitting that mark.

Is it the practice of actuaries to set an assumption, Mark, that its client, or an assumption recommendation to its client that only has a 50 percent chance of being met?

MR. JOHNSON: 15?

MR. LIPPS: 50.

MR. JOHNSON: 50?

Yes, in the public sector, there's a difference between -- the private sector and who makes the decision on the assumption.

In the public sector, the onus is on the board to make an assumption. And it's normally based on a recommendation of the actuary.

We have recommended to CalSTRS' board that they select an assumption of 8 percent, and they have. And the last time we did an experience study, there was just slightly greater than a 50 percent chance that they would enjoy an 8 percent return over a long period of time.

MR. LIPPS: Over a long period of time. But in a given year --

MR. JOHNSON: Oh, who knows? That could be anything. It could be -- and we're not dealing with that particular year. This is a long-term prospect. So I'm not able, nor is it necessary for me to predict what the return will be for one year or one month or tomorrow.

MR. LIPPS: Okay.

Jack, I think this question is for you. There was some mention that there's no intent to reduce retirement benefits through CalSTRS. There is one provision that's sunsetting, I believe, in 2010, relating to longevity and the $100, $200, $300 bonuses.

Is that up to reauthorization by the Legislature or is that something that the Board has any control over?

MR. EHNES: It requires additional funding, and it would be a legislative decision for sure. And I think what gives us heartburn, of course, is going back to that replacement percentage that I showed you on the board, the fact that it's between 55 and 65 percent, depending upon your date of retirement. So that is negatively impacted to the extent that benefit sunsets.

MR. LIPPS: Because I was going to ask about that retirement, the replacement factor in that. So that leads into my last question, Mr. Chairman.

The slide on page 2, where it says for new retirees, based on an average benefit there is about a 63 percent replacement factor --

MR. EHNES: I know what you're going to say yes.

MR. LIPPS: In the brochure, it doesn't refer to new retirees.

MR. EHNES: It's the entire retiree base.

MR. LIPPS: It says "median" as opposed to "average," but the 10 percent spread seems statistically a little large.

MR. EHNES: Well, we've been looking at those numbers. And one is, we do think given the extremities, that the median is a better statistic. So we were going to start moving those over to a median calculation.

Because as you as well said, we also -- it is a different scope, that fifty-three, four number is reflecting our entire retiree base. So it is those two differences that cause that difference, the change from an arithmetic mean to a median value, plus the entire retiree base, which there is definitely perceived accurately inequities from that retiree base of what the early retirees have versus our most recent group.

MR. LIPPS: Okay, thank you.

CHAIR PARSKY: Ron?

MR. COTTINGHAM: Getting back to the -- I want to ask a question about the shortfall, because you had indicated that the benefit enhancements that were created after they were implemented, there was still overfunding, you were over 100 percent funded in CalSTRS.

MR. EHNES: That's correct.

MR. COTTINGHAM: Had there been no benefit enhancements and the market would have done what it did, would you still have then experienced a shortfall in funding?

MR. JOHNSON: I haven't tested that particular question, but there is a portion of the statute which requires us to test the benefit that was in place in 1990. And if the benefit structure and the funding mechanism that was in place in 1990 had been in place for the last 16 years, up through 2006, there would still be a surplus, even with the poor returns in 2000-2003.

MR. COTTINGHAM: Okay, you still would have been able to have a surplus?

MR. JOHNSON: Again, that's 1990 -- and, again, there were not significant benefit changes between 1990, 1998.

So I guess what I would --

CHAIR PARSKY: The logic would be that the contribution reduction contributed the most to the situation you described then? If the benefits were not increased that dramatically, but the contribution levels were -- or not during this period, 1990, forward?

MR. JOHNSON: No, you're right. But we would have paid out fewer benefits during this period, since 1998. We would have had higher contributions, okay, working in the same direction. And even though if we had poor returns in 2000-2003, given those --

CHAIR PARSKY: Those dynamics.

MR. JOHNSON: -- those dynamics, we would have still had a surplus.

CHAIR PARSKY: Okay, I'm sorry, go ahead.

MR. COTTINGHAM: As Lee indicated in the last presentation, they talked about some of the contribution levels, or the projections, earning projections. And one of the things that was brought up and recommended is, I guess, twofold: Is if you're having volatility in the market, and this affects rates and contribution levels, should you invest in things that were, like, treasuries and bonds that are steady in their return, and should you lower your projections to -- and I think what was recommended at that meeting was around 5 or .5 percent --

would that help the system?

MR. JOHNSON: I'll let Jack or Ed weigh in on this as well.

CHAIR PARSKY: It's clearly not an actuarial question, but that's all right.

MR. JOHNSON: You know, I'm not an investment expert. But let's say you had a portfolio that the actuary expected to return 5 percent. This chart would look different. You would not expect the 63, or two-thirds, as the gentleman said earlier, 70 percent of the funding to come from investments. A smaller portion of the total funding would come from investment.

Yes, they'd be safer, but over a long period of time, you're giving up return. You're trading some risk for a higher return. And CalSTRS does an excellent job. They have excellent investment staff, they have excellent consultants to help them get the best portfolio they can with just the appropriate amount of risk. And to say that we could be safer with a return that's -- let's say it's going to average 5 percent, that's true, but then the taxpayers have to put in that much more money.

MR. EHNES: We really had just two states left in the country, until relatively recently, Indiana and South Carolina, if I remember right, that had those types of restrictions. And they've certainly let them out --

it was actually South Carolina is just going now into global equities. They finally made it to equities, and now they're taking the last step. And their benefit structures reflect the penalties of all that period of no growth, but certainly safer.

MR. COTTINGHAM: And when you're talking about having CalSTRS or the retirement systems being able to, within parameters, raise or lower contribution levels, I'm assuming that's -- it wasn't stated, but that would be employer and employee contributions? Because what I am wondering there is, obviously, most of the employer-employee contribution levels are set through memorandums of understanding. And how would you deal with that issue if you were in a current MOU? Because if you have to wait -- if you're put behind the curve because the Legislature cannot act quickly enough to change things for you, then I guess you're put behind the curve if the MOU currently in place prevents the same action.

MR. DERMAN: Well, the actions, the memorandums of understanding don't address the contribution rates paid by the employee because it's set in statute. So it's not a bargaining issue. So the more significant issue in terms of the employee contribution is that there's a constitutional limitation in terms of you can't increase the contribution rate that an employee pays without giving them something in return for that.

So, yes, there would be in terms of what we were suggesting to the board an increase in the contribution rate paid by the employee, but there would have to be some offsetting increase in the benefit to offset that.

We happened to identify one that, in fact, wouldn't cost the plan any money to sort of provide that economic justification. But there would be an increase in terms of what we were suggesting in the employee and the employer contribution.

But that's one of the reasons why we were suggesting, because of the bargaining implications in terms of having the employer and the employee paying more money, is that what we would propose would be deferred in terms of the board sets the rates, say, in July of -- or in April of 2008. It wouldn't take effect for another two years. So that people would have an opportunity to have their bargaining process adjust to whatever the increased contribution rates are.

CHAIR PARSKY: The last question, Dave?

MR. LOW: I just have a contextual question.

As far as I know, you're the only system that have come up here and said, "Our rates are all fixed," and all the other defined benefit systems have the ability to adjust their rates.

So what is the context? How many other systems are there out there that run like yours?

MR. EHNES: Ed can address that.

MR. DERMAN: Yes, we've been looking around. And we found a couple other state systems that have it. In terms of in California local plans, from the counties, the information we've got is there may be a handful in which the governing body, like the county board might set the rate or participate in setting the rate. But this is by far the outlier. I mean, I can't think of one that is as rigid as this one is.

CHAIR PARSKY: Thank you all very much for a very interesting discussion.

And we'll now take a break for lunch and be back in about 30 or so minutes.

Thank you all very much.

(Midday recess taken from 12:34 p.m. to 1:20 p.m.)

CHAIR PARSKY: Let's see if we can't resume our agenda.

And we have our next panel.

School Funding and Retired Classified and Certificated Health Care.

So why don't we hear from each of the panelists first, and then we'll go ahead and ask some questions.

Have you picked an order that you'd like to talk in?

MR. WALRATH: I understand we'll be going in the agenda order.

CHAIR PARSKY: Okay.

MR. WALRATH: Chair Parsky, Members, my name is David Walrath. I'm the president of Murdock, Walrath & Holmes. We are a firm in Sacramento. We represent the California Retired Teachers Association, individual school districts, and a number of organizations affiliated with public education. Thank you for the opportunity to talk with you today about this very important topic.

The first slide says everything. It is the reality. There is no retirement security without health-care security.

You've already seen the numbers on bankruptcies that occur because of health-care costs.

And on this point, as Mr. Ehnes, I am somewhat concerned with the charge of the Commission, in that it may be too narrow to address the comprehensive nature of the need for access to affordable health care in retirement.

I recognize the Commission's charge, looking at that which is currently provided or required by contract and law. But, unfortunately, as Jerilyn Harris pointed out, many retired teachers do not have retirement health-care security.

There are approximately 1,100 local education agencies in California. Each of them can bargain their current employee health care, can bargain post-employment benefits. I'd doubt if there is a single local education agency in California that has the exact, same health-care program as any other LEA. The span is tremendous. I will not even try to go into all the varieties because you definitely do not have enough time.

Schools are funded under Proposition 98, primarily. Approximately 86 percent of the funds will come from Proposition 98. The remaining approximately 12 to 14 percent, depending upon the district, will be coming from a combination of federal funds, local funds from foundations, or from the Lottery.

Schools do not have fee-levying authority except in very, very limited circumstances. They are constitutionally prohibited otherwise. They have very little local taxing authority. The State controls the allocation of property tax revenue, as Mayor Pringle I'm sure is aware, given ERAF and other factors.

MR. PRINGLE: Other factors.

MR. WALRATH: We can do a parcel tax. Two-thirds vote, but it is limited in time to four years before it can be reauthorized. Therefore, long-term expenditure decisions cannot be obligated or created through the parcel-tax mechanism. Almost every expenditure we make will come from current revenues. And when we talk about eventually funding currently accrued obligations for health-care cost, that will be coming out of current revenue and, in essence, is a trade with the ability to provide current educational services, since we do not have other independent revenue-raising authority.

The issue of a comprehensive state benefit system was vaguely and briefly addressed in the master plan for education, preschool through university, at which point it failed in the first committee, and it failed on the basis of both employer and employee deciding they would much prefer to retain the system of being able to bargain locally because of the flexibility that it provides them in addressing compensation issues.

Jerilyn Harris went through all of this, so I'll skip that quickly.

Just stating a position, a point of view from the California retired teachers: California is a tremendously rich state. If you look at the level of personal income that is dedicated for education, from the point of 1967 to now, you'll see an inexorable slide of the percentage of personal income in California that is dedicated to funding education.

The State is taking the lead on global warming. We think the State should also take the lead on insuring retirement security, which goes beyond simply the formula benefit of a pension.

Also, we believe that there should not be caps on what school districts can or cannot do. Why deny people the opportunity to allocate more of their current income for a more secure retirement?

In looking at how best to address the current and accruing liabilities because of the variations, a one-size-fits-all solution will not work. In California, the smallest school district -- and it may have grown -- but around three years ago, had seven students. The largest school district had more than 725,000. We have school districts that have more than 1,000 students per square mile, we have school districts that have fewer than one student per square mile. The variety of the circumstances are significant. A one-size-fits-all will not work.

We want to provide thoughts and recommendations for your consideration as you go forward.

Once again, back to slide one, which is our compelling drive: There is no security without health care. Expand PEMHCA to allow individuals and their dependents to join PEMHCA at a group rate. Public employees, retired teachers -- because we are not at the bargaining table, we cannot effectively change whatever benefits we currently have from the school district. And Jerilyn indicated some of the effects that were going on. Allow us in those cases where the school district does not provide subsequent health care, that the individual can go forward. I'm looking more at where we are now. We'll have other recommendations for what to do going forward rather than those who are currently retired.

Cap cost increases charged to retirees, to the amount that is charged for current employees on the percentage change between years. There are school districts that increase the charges to retirees by 24, 25, 40 percent in a year for buying into the school district health care, while for current employees, that amount is more like 8, 12, or 14.

Make it easier for school districts to join PEMHCA. This has been an issue that's been around for a long time. There are many subsidiary issues that are related to this, as to responsibility of the employer for insuring funding.

Finally on this, do not treat health-insurance post-employment benefits like defined benefit plan obligations. Formula-driven benefits are different than a health-care benefit. 2 percent at age 60 times highest compensation. The way you prefund that and how you prefund that is a lot different in an area of health care which is a tremendously variable and probably federally interventioned policy area in the next 30 years.

So the types of actions that you may want to take in funding may be that it is not practical to go to 100 percent prefunding of an obligation within the next 30 years.

There are generational issues, intergenerational transfer between current employees paying not only for themselves but for those who have gone before. We believe that it's practical to be at some number less than 100 percent. I used 60 percent simply as an example of something less than 100.

Long-term --

MR. PRINGLE: I'll bet you there's a few other options.

MR. WALRATH: Yes.

Long-term, we believe the State should provide a mandatory health-insurance benefit for all public education employees, and fund it in the same manner as the State Teachers' Retirement System was funded commencing in 1972, the Barnes Act, which was a slowly increasing state-supported, locally -- and partially locally funded contribution into STRS to meet the long-term cost.

And finally, although I know that this has had great legislative success, though not actual implementation success, the long-term we believe must be looking at something like SB 840. A comprehensive solution for everybody, so you do not have health-care transfer costs occurring from uninsured and others, some form of comprehensive universal health-insurance program.

With that, I'll conclude my comments.

CHAIR PARSKY: Thank you very much.

Nadine?

MS. FRANKLIN: Good afternoon, Chairman Parsky and Members of the Post-Employment Benefits Commission.

My name is Nadine -- what did I say? I'm sorry.

Post-Employment Benefits Commission Members, yes. Okay.

My name is Nadine Franklin. I will be addressing the post-retirement health benefits and pensions for classified employees in the California public school and community college districts.

I'm the senior member benefits coordinator for the California School Employees Association, where I assist our 221,000 active members and 11,000 retired members with retirement information.

Our members are classified employees and retirees from the public schools and community colleges throughout California. They are secretaries, bus drivers, food service workers, groundskeepers, security personnel, business office employees, para educators, custodians, maintenance workers, electricians, plumbers, painters, carpenters, mechanics, glazers, and locksmiths. They keep the schools running, clean and safe for students from preschool to college.

Some districts provide both retiree health benefits and pensions for classified employees, but many do not include retiree health benefits.

I will briefly cover some of the scenarios relating to health benefits, and I will also discuss the need to continue pensions for employees in their fifties and the logic of their defined benefit plan that is nearly fully funded.

Thousands of classified employees have no pension because they work less than four hours a day. Rarely do employers pay towards, or even allow employees access to health benefits. Some districts do allow these employees to be in Social Security, while others have adopted a qualified alternative to the Social Security plan. This leaves the employees with a small pension when they retire or none at all, perhaps a lump-sum amount. But they have absolutely no health benefits after retirement. And I think one of our recommendations here would be that the employees be allowed -- all employees be allowed to participate in a health benefit plan within a school district, at least on a prorated basis, and also that the retirees be allowed access to the district's health-benefit plan, at least.

Of the 221,000 employees that CSEA represents, approximately 71 percent of them are eligible to participate in CalPERS as a pension. Of that 71 percent, approximately 50 percent are full-time employees who work eight hours a day, 12 months of the year. And in most cases, they do have employer paid health benefits, and in many cases, they will have employer-paid retiree benefits.

Of the remaining 50 percent, those folks are employed anywhere from four to seven hours a day, and most of them for only ten months of the year. And of this group, many have no employer-paid health benefits as employees; and some of them will be covered on a prorated basis. But those who have no health-benefit plans, as an employee, obviously, will have no health-benefit plans in their retirement.

Since 1989, I have worked with many classified employees who plan to retire. And of the thousands of conversations that I have had with those folks, there's always at least one question about retiree benefits. And I always refer those folks back to their employers for answers to their health-benefit questions because there is absolutely no consistency whatsoever from one school district to another as to what, if any, health benefits are provided in retirement. In fact, there is often no consistency in what is provided full teachers, administrators and classified within the same district. In some cases, teachers or administrators may be receiving health benefits after retirement and a full-time classified employee may not have any at all.

Only 116 out of the 1,200 school and community-college districts in the state participate in the CalPERS health-benefit program. Several of the participating districts include administrators, certificated, and classified in that plan. Of the 116 districts, only 16 pay the full premium for health-benefit plans for retirees.

But wait, there's more. Out of those 16, three of the districts only cover one retiree. In two other districts, only two retirees are covered in the full paid plan. And then another district covers only 36 retirees.

In four of the remaining 100 districts, there are a total of 11 retirees in the CalPERS health plan with absolutely no employer contribution at all.

In two of the districts, they have a total of 310 retirees participating in the CalPERS health plan. However, the employer contribution is $1 per month. So you can see, that is not costing them a whole a lot of money.

Then there is the district that does pay the highest amount for health care. It's $1,862 a month. They have two retirees. I'm pretty sure they're school administrators -- or they were.

CSEA recently sampled 50 school districts that we represent. We found that of the 50, only two have access to lifetime benefits. Both contract with CalPERS, and both pay the minimum allowable, which this year is, I believe, $80.80 a month. Ten of the 50 districts do not provide any health care at all. And the remaining 38 districts provide coverage for retirees between ages 55 and 65. Most of them require 15 years of service for eligibility for health benefits.

Our labor relations representatives report that a very small number of school and community college districts are in the process of arranging for prefunding of post-retirement health benefits at this time, and at least two were reported to have a prefunding process that has been in place for a few years.

Discussions are beginning to take place in other districts on this subject. A sampling of California public-sector entities that was funded by the California HealthCare Foundation gives a bit of insight into the health-benefit situation in schools versus other public agencies. A total of 108 agencies from four California geographical regions were studied. And while the study refers to the 2003-2004 year and the percentage of agencies' total budget needed to pay for the retiree health benefits, it also projects the cost to the years 2019-2020. Today's total cost will be different, but I think how schools fit into the picture will be quite similar.

Of the 108 agencies, 20 school districts were included, 13 show well below 1 percent of the district's budget being spent on retiree health care, five districts fell between 1 and 2 percent, and two school districts fell between 2 and 3 percent.

These figures do not tell the story of how much of the retiree health-benefit costs were attributed to classified employees, however.

We do know that only approximately 40 percent of the 750 districts represented by CSEA offer any type of benefits for classified retirees. The most common type covers retirees up to Medicare age if they retire at age 55 or over and have at least 15 years of service credit with that employer.

Again, a small percentage of districts offer lifetime benefits. Of those that do, some have developed a lesser tier of coverage for the new hires.

In light of the fact that so few employees receive significant or lifetime coverage, the cost of retiree medical benefits for classified employees is small compared with other agencies, and so, of course, is the health-care coverage.

And that might be good news to those who are looking at retiree health-benefit costs to the taxpayers, which, of course, includes all public employees. But the bottom line is, many classified employees and retirees cannot afford health care, and they end up in other health-care programs that are also funded by the taxpayers, like Medi-Cal and Healthy Families. One way or another, the taxpayers pay, but they pay more in the long run if the employees are not in a group plan.

As has repeatedly been pointed out during these and other meetings, our nation's health-care system is seriously broken. The California School Employees Association strongly supports a single-payer plan that will save money and provide coverage for all workers and retirees.

The pension discussion for classified employees is another story. All of California's qualified classified employees participate in the California Public Employees Retirement System, CalPERS.

What qualifies an employee to be in CalPERS? Well, they must work four hours a day or more, 20 hours a week, or a thousand hours in a fiscal year.

There is interesting facts about classified workers' pensions. Classified employees and retirees make up 37 percent of the total CalPERS membership. However, they're eligible for the absolute lowest pensions from the system. These are dedicated employees upon whom the public depends to keep our young people safe, provide meals, transportation, and appropriate learning environments. Many employees directly assist students with all types of special needs.

Classified school positions might be the perfect example of why it's important to continue to make pensions available for people in their fifties. Try driving a school bus full of 30 to 50 to 80 high-energy children under the age of 12, or moving large, heavy containers of food and stacks of cafeteria trays daily, or many times a day lifting and moving students of all ages and all sizes who can't move on their own.

Injuries often occur from ongoing work in these types of positions. People often need to retire early, or they will end up retiring on a more costly disability retirement for both CalPERS and Social Security.

They must continue to have an earlier retirement option. Remember that many of these employees do not have retiree health coverage, and they will need that pension in order to be able to take care of themselves.

Those who speak against public employees retirement benefits often paint a picture of retirees who receive excessive pensions. These are the exceptions, at least within CalPERS. According to CalPERS’ statistics, the average school retiree monthly pension is $1,030 a month, or $12,360 a year.

The average disability monthly pension for school retirees is $723 a month, with over one-third of the CalPERS members receiving an annual average pension of just over $12,000 and another third, the retired state workers, with only slight higher pensions. Where are the excessive pensions? Classified employees' pensions at this level are earned after 15 to 20 years spent providing the setting for teachers to teach and students to learn. Out of their pensions, classified retirees must pay several hundred dollars a month for health benefits. Even though classified employees also receive Social Security, their benefits are often small because their salaries are so small.

So much of the debate surrounding both pensions and health benefits for public employees omits the fact that employees covered by health benefits sacrifice salary increases to pay for rising health-care costs. At the same time, they often have high benefit co-payments. They also contribute their share of their monthly income to the pension systems. Since pension boards carefully invest their pensions, at least the employees can hold their heads high in society, knowing that they will have some income in their retirement.

Certainly the bulk of these employees would not have the financial savvy to make such good investments on their own or the income to prepare them for retirement.

They stay with the lesser-paying jobs, however, knowing that their hard work will pay off down the road, and they will have money to live on when they can no longer work.

I've watched CalPERS grow over the years and observed the care with which the Board of Administration makes decisions that will impact employers, employees, and retirees. It's gratifying to assure employees that the contributions they have made during their service in the schools will provide them with lifetime pensions that they have earned and so richly deserve.

Their personal income contributes to the investment portfolio which CalPERS has used wisely to bring about a system that is over 93 percent funded. Only 25 percent of the money that is paid out in retirement benefits is coming from taxpayers. Again, since the employees are taxpayers themselves, they are helping to pay that 25 percent. In fact, half of it is paid by the employee contributions and the other half by the taxpayers, which also includes the public employees.

With the excellent returns that are being realized by CalPERS, it is projected that the system will soon be 100 percent funded. Where could the taxpayers get a better deal?

Money that is provided for CalPERS' pension soon won't be costing the taxpayers a dime, except that CalPERS will continue to collect employer contributions in order to make sure that in the future, when the returns are not as good as they have been, there will be money there to make up the difference.

We in CSEA do not believe there is any logic in diminishing pensions which, for the majority of the CalPERS members, are far from overly generous. And with proper modification to the health-care system, classified employees and retirees could have adequate health care during their careers and in their retirement.

So we do hope the Commission will, in fact, support the single-payer plan.

For now, and in conclusion, I think it's fairly obvious that the cost to the taxpayers for adequate retiree health-care benefits and pensions for classified employees in California is quite small.

And I will be glad to take any questions. And thank you very much for the opportunity to appear before you.

CHAIR PARSKY: Thank you very much.

Marty?

MR. HITTELMAN: Yes, my name is Marty Hittelman. I'm President of the California Federation of Teachers and a mathematics professor at Los Angeles Valley College.

And before I go into my more prepared remarks, I would just like to mention that in my reading, 80 percent funding for a pension system is very good, much better than most systems in the state. And I believe that 100 percent funding is a waste of the taxpayers' money. It should be spent on other things.

Secondly, we are opposed to STRS having the ability to increase the employer-employee contributions. If they want the increase, they should just go to the State budget and ask for it since it's all state money, anyway. Why take it for the individual schools instead of taking it from the state as a whole?

Now, health benefits, many employees of the California schools and colleges have been willing to accept lower salaries during their working lives in exchange for the benefit of the health-insurance coverage into retirement. They paid for the retiree health benefits while working and expect the promise of health care to be kept. Now, some are calling for a rejection of these contracted rights to post-employment health coverage, or moving to a two-tier system, which is deadly to the system and to the employee morale.

The opponents of the public employee benefits point to long-term actuarial reports showing huge unfunded obligations.

The change in the cost of post-retirement benefits represent a very small and easily manageable portion of district costs. One of the major drivers of the movement to deny employees their hard-won health benefits is the newly established Governmental Accounting Standard Board, GASB 45 reporting standards.

If the reduction in benefits is not the planned result of GASB 45, then it certainly is a likely result. GASB 45 has become an integral part of the attack on the worker safety net. Actuarial results are also being used by management to deflate faculty and staff salaries and benefit increases.

Prior to GASB 45, public employers were only required to report the annual amount that they actually paid for current retirees' benefits.

Most districts still pay their post-retirement benefits as they are due and have done so without any problems for many years. Districts now will be required to report on the cost of future benefits that current employees earn during the fiscal year, as well as the value of benefits earned in prior academic years.

Except for the cost of the accounting, no new costs for benefits coverage are created by GASB 45. The only new cost for benefit coverage would occur if an employer decided to put money aside in order to fund the long-term 30-year liability, in addition to its current pay-as-you-go obligations.

These new set-aside costs could become a major problem -- a much bigger problem than any ongoing expensive benefits.

At first glance, the obligations are horrific. The Los Angeles Community College District, in which the LA Valley College exists, was quoted as an actuarial accrued liability of $632 million. Currently, the district is spending about $26 million per year in retiree medical costs.

The Los Angeles Unified School District had an estimated liability of $4.9 billion. Currently, the LA Unified School District spends approximately $177 million per year for retiree health benefits.

As one can easily see, the unfunded liability dwarfs the actual pay-as-you-go cost.

It must be noted that actuarial projections on retiree health-benefit costs are highly speculative, especially over a 30-year period. Actually, in a one-year period, according to STRS, it went from 22 to 9 projection, a 13 percent decrease in one year. Imagine how unpredictable a 30-year actuarial is.

Very slight changes in the assumptions related to costs and return on investment result in huge changes in the projected liability. The factors that actuaries use, such as rate of return of investment, health-care costs, and the demographic makeup of the employees and retirees, change from year to year. A good actuary should have the ability to provide either a best-case or a worst-case scenario, hopefully both. Districts should ask for both.

The experience in Los Angeles Community College District, like most districts, the LA Community College District has been paying for their retiree health care on a pay-as-you-go basis, paying only the amount of actual benefit costs for retirees in any given year for more than 30 years, and has been operating on a pay-as-you-go system all this time without any major problems.

The percentage of general-fund apportionment spent for all benefits in 1989-90 was 18.1 percent. Basically, the district has stayed around 19 percent, up or down a couple of percent, for entire benefits, not just for retiree benefits. The increase in benefit costs is a problem but not a disaster for districts, nor will it be in the future years.

The LACCD GASB 45 valuation report prepared by Demsey, Filliger & Associates as of July 1st, 2005, contained a comparison of the costs -- and I've included that in my written statement -- to fund a retiree health benefits of current employees using pay-as-you-go and several other methods. A level contribution for the next 20 years, a level percentage of the unfunded accrued liability, and a level percentage of payroll for the next

20 years.

You will note that for 2005 GASB would require a payment of almost $55 million, while pay-as-you-go would only require about $26 million. I have found that the doubling of costs by moving to a pay-as-you-go is a common result. It is important to note that even after ten years the amount the LACCD would have to pay for the benefits of retirees is less than the amount required by GASB in just one year. Meanwhile, all of the excess funding has not been available to provide service to students or salary increases to employees. Over the period of time that I've shown, the overpay is in the range of $200 million to move to an actuarial as compared to pay-as-you-go.

Many pundits believe that the current pay-as-you-go retiree health benefits will lead to major problems in upcoming years as the mounting liabilities becomes due. The fact that this has not occurred yet in districts like the LACCD and the LAUSD that have had such a benefit for more than 30 years -- a lifetime benefit, by the way -- seems to have little effect on reducing any fears that they might have concerning the impropriety of using the pay-as-you-go methodology.

The probable emergence of a single-payer universal health-care system, which would relieve districts of their retiree health-care responsibilities, since such a health-care system could be responsible for the health-care costs of retirees, in California or the United States over the next 20 years also has little impact on their fears.

The large relative cost as opposed to pay-as-you-go or prefunding retiree health benefits in the private sector has clearly led many private companies to abandon the welfare of their employees. But private companies are very different than public schools. Public schools are not going out of business. The need for public agencies to protect workers' benefits into retirement is very different from that of any private employer since the income of the public institutions will continue. If a public institution ceases to exist, the assets can be sold off to pay for the ongoing health-care requirements in a way that may not be available to private-sector businesses.

In the discussion revolving around GASB 45, not much emphasis has been placed on the real underlying reasons for the increased cost of health care. The California Health Care Coalition is one of several groups compiling data on the costs of health care. The data that they have collected demonstrates clearly the strong relations between skyrocketing health-care costs, badly practiced medicine, and hospital bills. The CHCC is active in adopting common standards for provider participation, collaborating with CalPERS and other purchasers to build local purchasing coalitions, negotiating collectively with providers, educating the public, and studying hospital and other costs in targeted areas of California.

Research by the CHCC and the California Education Committee for Health Care Reform, a coalition made up of management and labor, has made clear that the increased costs has come from the supply side, not the demand side of the equation.

The usual explanations for increased costs -- aging population, high cost of new technology, the provider cost driven by trial lawyers, the development cost of new wonder drugs, and the irresponsible consumer -- have not been found to be the dominant drivers of the inflation in medical insurance premium. And I point out some of the other problems in our health-care system.

So instead of concentrating on GASB 45, districts should be taking steps to address the real reasons for the increasing costs. They should join the Health Access California, the California Health Care Coalition, the California Education Committee for Health

Care Reform, in order to increase the influence of these organizations. Until purchasers organize to demand delivery system reform and performance accountability from health plans and providers alike, the problem with our health delivery system will continue and the cost pressures on public-sector employers, unions, and workers will grow.

Districts should be spending more time on fixing the provider problem by identifying the best hospitals for each type of operation and inform or encourage patients to go there. Encourage preventive primary care. Developing locally based coalitions like those being formed under the umbrella of the California Health Care Coalition, to get the information needed to bargain effectively, require doctors to write prescriptions through a computer system that checks for negative and correct dosage.

In conclusion, leaving the pay-as-you-go method of funding and adopting a more expensive method will deprive students of classes and employees of wage increases.

I don't believe that it is fiscally responsible at this time to move away from pay-as-you-go into another way of funding retiree benefits.

In any case, we don't need to make any hasty decisions. Even the worst doom-and-gloomers agree that any problems will not occur in the near future. Most experts agree the accrued liabilities is not, in the short run, a real debt. Others point out that any problems that may occur will not occur in the next five years but more likely over a 30-year span.

Districts should take the necessary time to study the scope of any real problems posed by continuing their pay-as-you-go coverage of retiree health benefits, and should not be driven to rush precipitously to so-called solutions which, in the long run, harm everyone: students, employees, and retirees alike.

CHAIR PARSKY: Thank you very much.

MR. SUMMA: I need the clicker for this.

I'm getting my lesson.

Okay, good afternoon, Chairman Parsky and Members of the Commission. My name is Dom Summa. I'm the assistant executive director for the California Teachers Association, and I manage the department called Negotiations and Organizational Development.

And we essentially handle negotiations, training, research, and finance for CTA. And CTA represents over 340,000 members throughout the state of California.

And one of the responsibilities we have within our department is to -- whoops, let's don't go that direction.

MR. PRINGLE: No, no, go there.

MR. SUMMA: I wish we could go there.

MR. PRINGLE: What I did on my summer vacation.

MR. SUMMA: You're going to try to fix it?

Okay, get off the beach.

I know, but I’d rather see it up there.

(Brief pause due to technical difficulty regarding slide presentation)

CHAIR PARSKY: Why don't we do this? Why don’t we hold off, and we'll ask some questions, if any have arisen, with respect to the other panelists that have spoken? And then when -- unless you'd like to just talk without the slides.

MR. SUMMA: Yes, because I think a lot of the issues that I'm going to talk about were also mentioned by previous speakers.

CHAIR PARSKY: Then go ahead.

MR. SUMMA: If you have the presentation in front of you, then we'll catch everybody up with it.

CHAIR PARSKY: Great.

MR. SUMMA: One of the things we do within our department is we maintain a database of contracts that have been negotiated throughout the state.

I'll wait for the Commission to get ready.

CHAIR PARSKY: Okay, Mr. Summa. Go ahead.

MR. SUMMA: Thank you. One of the things that we maintain in our database is about 900 contracts throughout California. And we've done an analysis to kind of determine how many of these actually have what we call post-employment benefits. And apparently about less than 50 percent have some form of post-employment retirement benefit, and less than 10 percent of these contracts offer anything similar to lifetime benefits.

And in most cases, the premium cost of these policies is shared between the employer and the employee. This is not a fully funded employer-paid post-benefit.

And the ones that don't offer the lifetime benefits, in most cases, offer them for a limited period of time. Usually to fill that gap between the age of retirement and eligibility for Medicare. And as we said earlier, that runs mostly anywhere from age 61 to age 65. And many contracts have a cap or a maximum of five years of benefits after employment, or until that person is eligible.

You heard some figures earlier today from CalSTRS. And essentially 62 percent of retired educators age 65 and older do not receive any financial assistance in their health coverage from their provider.

And a recent report from CalSTRS, a policy report in May 2007, indicated the level of coverage has actually been decreasing. And one of the probably more significant figures in there showed that the percentage of employers providing benefits after 65 has decreased -- rather, I'm sorry, the ones that have no payment after 65 increased from 18 to 28 percent.

Part of the reason for this is, in the last few years, you're aware of the rising cost of health care, and the decision was made at the local bargaining table to use those dollars to provide other benefits or current benefits and not expand benefits for retirees. And, obviously, that's had an impact on the number of retirees who now receive some form of post-employment benefit.

A comment was made earlier by one of the speakers that the local employer determines the health-benefit support. Well, that's really not a true statement because, you know, with these 900 contracts, we probably have 900 negotiated agreements, each with a different twist to it, as far as the eligibility.

And we have some examples where employees have to work 15 consecutive years prior to retirement in that district before they're eligible for a retiree benefit. So you can see that where they've been negotiated, they've been used primarily as a retention tool. And

I'll talk about that briefly as well.

STRS, when they made the change to go from a 2 percent flat at age 60 to a higher percentage if you waited until 63 or 64, ended up having more teachers wait before they retired.

You saw a slide earlier that said the average teacher's salary increase has gone up over the last few years. Part of the reason for that we believe is because the average age of teachers has gone up, and the level of experience has increased as well. So as a result of that, naturally, the average salary would go up with that. So I think, you know, it’s somewhat misleading that the costs are being driven by some of these extra services.

Another comment made earlier this morning, talked about the Medicare eligibility. There are 176 districts in California that have not yet voted on whether to allow their employees to be eligible for Medicare. So we still have a fairly significant number of our members who are not receiving or may not be eligible for Medicare B. Now, they'll get A if they retire through STRS, but they would not get B coverage under Medicare because they have not participated in an election.

Most of these teachers are probably in their forties and fifties now. So we may not see an impact until they actually retire or unless some other options appear later on.

The fact that these post-employment benefits have been negotiated locally indicates that, you know, there's some reason why some have and some have not. In some cases, those with lifetime benefits tend to be the wealthy districts.

If you look at the list, you'll see places like Los Altos in Santa Clara County, also up in Marin County, Palos Verdes, some of the Kern County districts with the oil wells. You know, they provide some form of full coverage for employees when they retire.

We also see several high school districts, because the way our funding is in California, high-school districts receive a higher per-pupil amount than the elementary districts. So they have a little more dollars. Maybe they use that as a retention tool and a way to attract teachers, so they have some form of retirement benefit on a lifetime basis.

But the primary driver in this area are the urban districts. And the fact that the urban districts have negotiated, by and large, most of these fully-paid retirement plans is a result of a number of factors, one of them being that the urban districts tend to be underfunded. And the only way that they could attract and retain their teachers was to provide some kind of benefit down the road. So they would essentially use the lifetime benefit as a tool to attract and retain their teachers. And certainly throughout the years the bargaining has resulted in trade-offs that have caused them to give up benefits, salaries, or otherwise in order to maintain those lifetime benefits. So, again, I think we have to be careful how we look at this because the rationale behind these benefits varies from district to district.

The other thing about the benefits relates to GASB. And I think Marty talked about that in depth. I'm not really going to go into it in that much detail. But you do have a quote in my presentation from Standard & Poors, which says essentially, you know, you can look at pay-as-you-go, you can look at other ways to address these benefits; but, you know, most public employers will figure out a way to take care of it. That is not something that you have to be overly alarmed about.

We also have throughout the state a number of districts that are looking at declining enrollment. And, again, that will have a major impact on their costs as well.

One of the slides in my presentation talks about savings. And, again, in the school district business, there are some rather unique features as it relates to employees as they get older. Naturally, their salaries are up there. Maybe when they're at the max, they might make $80,000. And if they retire and receive several years of health benefits and they're replaced by a teacher earning $30,000 to $40,000, there's going to be this concept that we call "breakage." There's a difference between the cost of that teacher going out at the top and the cost of hiring, bringing somebody in. Those generate significant dollars that the district can use on a pay-as-you-go basis in order to cover those retiree benefits. That becomes even more a factor where you don't have to replace that employee. So about half of the districts in our state are in declining enrollment. They may not have to replace. In fact, the incentive would be to have that teacher retire at the top of the scale and be replaced -- or not replaced, and generate significant savings. So, again, those factors have to be considered when you look at the cost.

Districts with these benefits entered into them through the bargaining process. There was good-faith bargaining trade-offs as a result. And, you know, because of that, we should be very careful and cautious of any attempt by a state or organization or agency to impose or come up with some way to kind of say, "This is how it's going to be.”

These districts entered into free bargaining to receive this benefit; they have to work it out among themselves in order to figure out how to take care of it. And I think we would certainly be very cautious of the State coming in legislatively or the through the initiative process to say, "This is how it's going to work."

One of the slides that is in here, I hope you don't take it personally, it says, "It’s the health-care costs, stupid." And the "stupid" remark applies obviously to the comment by, I think, it was then-candidate Bill Clinton in 1992 that “It’s the economy, stupid.”

If you really want to look at a reason to deny health benefits for retirees, the major argument is, well, it's costing us a lot of money. Well, here in California, hopefully after we get a state budget, our Legislature will look at that issue and come up with a way to deal with the rising costs of health care.

Again, we believe that, you know, there are ways to attack health-care costs. Again, Marty mentioned some of it.

I have to give you a disclaimer. I am CTA's representative to our Education Coalition for Health Care Reform, and we are looking at things like value purchasing, we're looking at training for insurance committees, we're looking at centers of excellence. And, again, you've heard legislatively that single payer, if it were to go into effect, would pretty much wipe out the need for GASB and ensure a certain level of health benefits for all Californians, not just retirees.

In conclusion, the famous two words that you like to hear, we don't want to see a mandated solution. We think that this is a local decision unique to California school districts through the collective bargaining process and that should be the process used to resolve it.

We also very strongly share in the comment made by Chairman Parsky earlier, and that is, that we both have an interest to attract quality people to public employment. And I think when you look at health-care benefits, that's certainly a good way to attract people to this field and retain them and hopefully provide the best quality education for the students that we serve.

Thank you.

CHAIR PARSKY: Thank you all very much.

We're open to questions from our Commissioners.

Yes, Curt?

MR. PRINGLE: I just have a couple.

First, Dave, I don't know what PEMHCA is.

MR. WALRATH: It's the health-care plan that's operated by PERS, Public Employees Medical Care Hospital Act.

MR. PRINGLE: And you suggested, one of your key suggestions was to make it easier for retirees to join or participate post-retirement, is that --

MR. WALRATH: Correct, because when you're talking about that 28 percent.

MR. PRINGLE: So what would be some of those ways? What has been contemplated?

MR. WALRATH: In the past, there have been some discussions about trying to create a separate pool that would be used by individuals to come in. Because if you're no longer covered or you have problems of buying individual coverage, the cost of that is significant.

If you're in a smaller school district, you're going to be rated in that smaller pool, and that cost can be significantly greater than if you're rated in a larger pool that's a statewide. So it's cost savings on pooling capitation.

MR. PRINGLE: Okay, thanks.

CHAIR PARSKY: Any -- yes, John?

MR. COGAN: Nadine?

MS. FRANKLIN: Yes?

MR. COGAN: You mentioned, I believe, that only 116 out of 1,200 of the districts participate in the CalPERS health benefits program.

MS. FRANKLIN: That is correct. That is the figures that I received from CalPERS.

MR. COGAN: So why is it so low?

MS. FRANKLIN: I think part of it reason that there's such low participation is that there is a requirement to have some commitment to the retirees. And that seems to be, or has historically been one of the reasons that districts haven't participated.

I think another reason is that until they began the regional rating in the CalPERS health-care system, there were a lot of school districts, especially in Southern California, that could actually get a better rate locally.

MR. COGAN: Right.

MS. FRANKLIN: And I think that may have changed a little bit now.

MR. COGAN: I see.

And, Marty, thank you very much for your terrific presentation. I thought you were very eloquent, and you presented the argument the best I've heard. But -- there's always a "but."

My dad used to say to me, “John, just ignore everything before the ‘but.’”

But in this case, we shouldn't. I think many of the points you've made, I agree with, but I want to press you a little bit, if I could, on the prefunding.

When I think of prefunding pensions, I say to myself, well, the benefits of a pension program are a lot greater when we prefund. The ability of employees to contribute to their own pension plan, the ability of taxpayers to pay for their part are limited. And so when we prefund a program, and as we've seen 50 to 70 percent of the benefits of a pension program are financed out of investment returns, we could finance a higher level of benefits for employees with the same contribution by them and by the taxpayer. And so I see one of the real benefits of prefunding is higher benefits -- pension benefits.

I also see that benefits are more secure.

Dave, you mentioned that retirement security is dependent upon health security in retirement. And I think that's absolutely true. When we fund health-care benefits up-front, we're putting dollars behind the promises, and that makes those promises a little bit more secure.

And finally, given the ramp-up in retiree benefits, I see prefunding as a way of reducing the burden that gets imposed on our children for paying for the promises that we make today.

And so given -- I see these especially in the pension-benefit world, I guess I'm wondering, why, don't those same arguments and reasons apply to the health-benefits world? I mean, you said -- I thought I heard you right -- that if a pension program was 80 percent funded, that would be good; 100 percent, maybe not. But 80 percent, definitely good.

Why is it good for a pension plan to be funded at 80 percent and a health-care plan at zero?

MR. HITTELMAN: Well, I don't know that there's an easy answer.

One answer I would say is the money is so much less. You know, the money for the retiree benefits is really a fraction. You know, I said I would guess that the retiree benefits is probably less than 2 percent of the district's budget, which means that a 100 percent increase in the cost of the retiree benefits wouldn't be very much money. But prefunding is very expensive and would really take a lot of money out of the -- as I showed when you take -- say, in the LA Community College District, instead of paying the $28 million, you're paying $65 million, that's a lot of money. That's a lot of classes that you've cut for a safety edge that you really don't need. Because the pay-as-you-go, you could go, just that one year, three years, and pay for that 65. I mean, if you look at the amount of money that it's going to cost over ten years, you could see it's not even as much as it cost in the one year. So that's the first thing I would say.

Secondly, I think it was pointed out earlier by the STRS people about how to judge health-care costs. I mean, if you look at health-care costs, in one year there was a spike down -- a huge spike down, and that was when Clinton was elected and Hillary Clinton started talking about health-care reform. Okay, I would guess --

CHAIR PARSKY: We can take one Clinton in discussion. Two Clintons is a little bit too much. But that's okay.

MR. HITTELMAN: Not for everybody, Chairman Parsky.

Well, Hillary has changed her mind so…

Anyway, the discussion -- so much of the health-care cost is profit and overhead and so on, that you could cut 25 percent just by making it a state system. So health care is such a variable cost in total, it would be very hard over a 30-year to do a real actuarial. So I'm not saying that no one should ever put some money away.

And, in fact, the ability -- I think there's a bill now to put the money into a PERS program, where currently if a district wants to put money away, they're very limited in how they can invest the money. So they get a very small return on the money. But if they could invest it in STRS -- which I understand there's a bill now that has a very good chance of passing and being signed, which would allow districts to buy into that -- then it might be worthwhile for some districts. And, in fact, in the LA Community College District, they did agree to take 1 percent of the salary increase and put it aside for health care.

MR. COGAN: So your message to us is, it's not necessarily "Don't prefund" but "Be very cautious"?

MR. HITTELMAN: Be very cautious and know what you're doing, and understand the long-term cost of going from a pay-as-you-go to a prefunding.

CHAIR PARSKY: That's a very good comment.

Yes, Lee?

MR. LIPPS: Dave and Marty and Dom, you all mentioned Proposition 98 as the basis for funding K through community colleges.

I'd sort of like to blend this with the last presentation we had. If the employer contribution rate were increased, whether it was increased legislatively or increased by the power of the STRS board, should they get that kind of power, would that money come from outside of the Proposition 98 guarantee or would it come from within the existing funds that schools get for Proposition 98?

MR. WALRATH: From within the existing, the calculation of the minimum guarantee.

MR. LIPPS: And so what kind --

MR. HITTELMAN: I think it would depend on how it's done and it might trigger a lawsuit. In other words, if PERS does it itself, it may be something outside of Prop. 98. Currently, the cost is within Prop. 98. So it depends on how it's done.

MR. SUMMA: Yes, I mean, any attempt recently to shift that would have been at the expense side of the 98 side of the budget. So it would have reduced the dollars available for other programs or services that districts are now providing.

So, you know, that's the only pocket that it could come out of.

MR. WALRATH: My presumption is that the State 2 percent was going to continue, and it would not be shifted to the employer. If the State 2 percent continues, then the question is, if the State were to increase the employer contribution rate, would that be inside and currently the employer contribution rate is inside.

The question then becomes if you do that, do you increase the revenue limit at the same time, the same way as you treat PERS contribution rate increases which are inside.

Would there be a possibility of litigation? I would think that, yes, there would be a possibility of litigation under that situation, because the legal question comes: Did the State effectively transfer from 4.3, the difference between 4.3 and 2.0?

MR. LIPPS: Because the 4.3 was outside of the Prop. 98 base?

MR. WALRATH: Right.

MR. LIPPS: And then so the impact would be immediately felt then in the reduction of either educational programs or some other kinds of reductions to make up for however much the employer contribution rate was increased?

MR. SUMMA: If the employer receives a pot of money and if they have to make more money out of pot to cover an increased contribution, that's less money for everything else.

MR. LIPPS: And would that be similarly true if districts were to begin prefunding retiree medical benefits for its employees to the level of its unfunded liability. However that's amortized out, would that same concept be similarly be true, taken away immediately from this year's programs for future liability somewhere down the road?

MR. SUMMA: Yes.

MR. WALRATH: Yes.

MR. PRINGLE: Mr. Chairman?

CHAIR PARSKY: Yes?

MR. PRINGLE: Therefore, the same question would be, has there ever been a time in California's history since 1990 that the Legislature funded beyond the Prop. 98 floor?

MR. HITTELMAN: Yes.

MR. PRINGLE: So what you just answered is all irrelevant because, in fact, the Legislature has the right and always can have the right if, in fact, they give the tools to the STRS board to allow for an employer contribution increase, they also can increase the amount of funding to local school districts to match that; they can also fund it outside of 98 as they have with the 2 percent. They could also have a one-time or multiple-year benefit increase if, in fact, they felt they wanted to pass legislation to require some degree of prefunding on health care, they could very similarly ask that that fall outside of 98 or be an augmentation to the floor -- which I have been taught over many years, Prop. 98 is a floor, and --

MR. HITTELMAN: It’s not a ceiling, yes.

MR. PRINGLE: -- and all of a sudden every one of the folks that have been arguing that point to me have taken true the answer to your question the opposite perspective that Prop. 98 is, in fact, a ceiling. But if it is established as a floor for education funding, the Legislature does have those tools, too.

MR. HITTELMAN: I absolutely agree with you. And that's why I think it's a job for the Legislature and not for STRS. That's why I think that if STRS calculates that we need this much more money instead of asking the districts to pay for it, since it's all coming from the State anyway, go directly to the Legislature –

MR. PRINGLE: Is it all coming from the State anyway --

MR. HITTELMAN: -- and ask the Legislature --

MR. PRINGLE: -- though?

MR. HITTELMAN: What?

MR. PRINGLE: In fact, your minimum base education funding is not necessarily the same from district to district. Individual districts do have different funding sources.

My fine districts in the City of Anaheim do not receive the same amount of state funding as your fine districts in the County of Los Angeles because of a preestablished property tax distribution through ERAF. Therefore, we all know there are various pots and, therefore, as Dom pointed out, the legislative -- each individual district has had, through the bargaining opportunities, the opportunity to discuss health-care benefits for classified employees or health-care benefits of teachers and post-retirement benefits. Those have all been a part of a negotiated process. And, in fact, the only thing that's not a part of that negotiated process is, in fact, that based upon retirement.

MR. HITTELMAN: So your argument is, it's a good idea for the Legislature to do it, since bringing it down to the local level would cost a greater percentage of the budget for those districts that you're concerned with?

MR. PRINGLE: No, I'm just trying to find consistency in a few of the arguments and see through this whole maze of inconsistency in funding of programs and the types of retirement benefits and OPEBs that are available. Is there a point of consistency that this body can address? I have a hard time seeing it.

MR. LIPPS: Well, Curt, if I may, the only real consistency that you could point to is the inconsistency of the legislatures and the various politicians, because sometimes, yes, they have, in fact, overappropriated -- if "over" is the right word -- they have appropriated in excess of the Prop. 98 minimum guarantee; other times, they've held right to it; and other times, they have underfunded it.

When they have -- depending on what has happened with the funding level, as you all are too painfully aware, other parts of the Legislature had to be dragged screaming and kicking or with the threat of lawsuits or actual lawsuits to have funding restored that was believed to be constitutionally protected.

So when I asked my questions, it was, given today's economic reality in the state where we have a tight budget, if the employer contribution rate were ordered to be raised in some enforceable manner, where would it come from? Yes, in fact, the Legislature could augment base revenue limits. Mr. Walrath mentioned that, just like they did with the attendance incentive in 1997. There are all sorts of things that could be done. But the reality is, it would take a great deal of pressure from one side, you know, in order to get those augmentations done, if we had a state budget that allowed for it in any given year.

MR. PRINGLE: Exactly.

CHAIR PARSKY: John?

MR. COGAN: Just one quick question.

Nadine, I think you mentioned that there were two districts that have started prefunding their health benefits.

MS. FRANKLIN: Yes, that's my understanding.

MR. COGAN: Would it be possible to get some more information on the two districts?

MS. FRANKLIN: I can do some research and make that available. I know which districts they are, but I don't know exactly the process they used or for how long.

MR. COGAN: Right, whether they've started small, how they've financed the –

MS. FRANKLIN: Yes.

MR. HITTELMAN: The Peralta Community College district did a bond.

MR. COGAN: Did a bond for it?

MR. HITTELMAN: Yes.

MR. LIPPS: Elk Grove Unified was one of the two districts –- or is one of two districts.

And Lori?

LORI: You’re right. They prefunded.

MS. FRANKLIN: Then there is one more, because those are not either of the districts that I was aware of.

CHAIR PARSKY: Okay, thank you. Thank you very much. We really appreciate this panel.

DR. GHILARDUCCI: I'm sorry, I'm trying to jot down some notes about what I learned from your testimonies.

One I learned is the great inequities that have occurred because of local bargaining. Some of the school districts are wealthy and, therefore, have what retirees need -- provide retiree health insurance. And then Dom has argued that the best solution is for local negotiations. That's not inconsistent, but we do have to realize that it's led to all these inequities.

Mr. Walrath, you have recommended that it be even more local than the local district, in that each individual, each household decide whether or not they want to buy into retiree health. And you've offered a way that people might be able to do that in an affordable way.

And then I hear from all of you that perhaps the best solution is a collective solution, not local at all, which is to lower health-care costs, which I think we probably would all agree would help us out. Meaning not all agree on universal health care, but that would help, too.

Is that what I should get from this panel?

MR. WALRATH: Not from mine. So let me try to be clear.

You have, first, dealing with that which is right now for current retirees. They can't get back to the table. So, yes, on them, individual.

DR. GHILARDUCCI: Let them go? Got it.

MR. WALRATH: Because of that reason.

As far as bargaining, we believe there ought to be a mandatory minimum, and then you can bargain above that minimum in order to address issues of recruitment, retention, and like that. But that nobody end up who are current employees end up in 5 or 10 years where they do have nothing there.

DR. GHILARDUCCI: Okay, okay.

MR. SUMMA: Just one more comment.

The idea that some districts have different levels through the bargaining process means that they should get an attempt to resolve any issues or problems from that without a mandate that this is how it's going to be solved. Because the Legislature will not know what the background is that went into that particular settlement.

DR. GHILARDUCCI: Sure.

MR. SUMMA: How the trade-offs were done, why they agreed to a ten years' rather than five years' waiting period, et cetera, et cetera, et cetera, so --

DR. GHILARDUCCI: Would you disagree with Mr. Walrath that there should be a minimum?

MR. SUMMA: No.

DR. GHILARDUCCI: You do agree that there should be some minimum that the parties have to deal with?

MR. SUMMA: Oh, yes. Yes, I think there needs to be some level. And whether it's a larger pool that says, "Look, we're going to provide retiree benefits up to this amount, and then if you want to negotiate beyond that that, you're free to do so."

DR. GHILARDUCCI: Sure.

MR. HITTELMAN: And I would agree that there should be some levels. But a lot of it is not philosophical; it's tactical, and that is, who can you best bargain with.

And my feeling is that you don't do very well bargaining with the State Legislature or the Governor, that you have much more impact bargaining at the local level.

And so as a tactic, I would take that position.

Health care, though, because it's so regional and state -- actually, I think it's pretty regional, not necessarily state, that it's probably worth looking -- that's why universal health care is so desirable, is because you pool all of the residents, not just your local pool.

CHAIR PARSKY: Okay, thank you all very much.

We will now move to our next panel. One table, two panelists -- or two tables. Two tables? Okay.

Okay, which order?

You're first, Rod? Okay.

This is Private-Sector Pension and OPEB Options.

MR. CRANE: Thank you, Mr. Chairman, Members of the Commission.

First of all, I'd like to thank you for the opportunity to address you. My name is Rod Crane. I am a director with the Institutional Client Services Division of TIAA-CREF. And prior to coming to TIAA-CREF a couple years ago, I spent about 20 years in the public sector consulting and actuarial field, consulting mostly to statewide defined benefit and defined contribution plans.

My focus today is going to be on a couple of different topics. First of all, a brief outline of the public-sector versus private-sector perspectives with regards to these particular issues.

Next, I'll move on to a discussion of a possible set of best practices for public policymakers as you tackle this very, very tough issue.

But before I dive into that conversation, I want to make it clear we're not here to advocate any particular set of solutions. So we're here as a subject-matter expert, just to address information and questions that the Commission may have to help along with its endeavors.

So let's begin.

Looking at the public sector and the private sector, at the highest levels, I think we observe a few things. First of all, that they operate in similar -- not identical, but certainly similar environments. Accounting standards are driving decision-making and policy making. The federal environment is similar. The tax code, although not identical, it's similar. Fiduciary rules, workplace issues, global economy, and capital markets, they all function in the same environment.

Both are concerned, of course, with workforce management. You've heard that multiple times, through the attraction and retention issues of various employee classes is very important, particularly in the teacher world, where the attraction and retention issues of aging

Baby Boomer teachers is of critical importance. Cost efficiency and, of course, enterprise risk management is of top concern.

One of the major similarities is that both the public sector and private sector are concerned with the allocation of limited resources against unlimited demand for those resources. And that's where we come to the discussion of how the public-sector and private-sector perspectives begin to differ?

There are a few observations here.

First of all, the stakeholders and customers are rather different. It's as simple as observing that investor interests and taxpayer interests are different.

We have to also observe that the basic missions and functions between public sector and private sector are rather different. It's, again, as simple as observing as manufacturing soft drinks and selling them is rather different than ensuring the public welfare and the public safety.

Governance structures are also fundamentally different. This is a political environment. That's just the nature of government.

We conclude, therefore, that it's improper to say that private-sector solutions and that private-sector responses that we'll review next, really are a measure or a good fit for the public sector. Rather, that unique solutions are going to have to be crafted.

So what has the private-sector response been over the last 15 to 20 years? A few things can be observed, and this isn't new information for the Commission. But we have seen, of course, a massive decline in defined benefit pension plans, with a shift towards relatively unmanaged participant-managed 401(k) plans, with the focus on wealth accumulation as a primary objective at the expense of retirement income.

We have seen a massive decline in retiree health benefits and promises, and even a massive decrease in access in the private sector for retirees. This means -- really, it can be summarized as a major cost- and risk-shifting to the shoulders of employees.

What's going on in the private sector that is driving this cost- and risk-shifting? A number of factors all come into play.

Federal tax policy is one, minimum and maximum funding standards. Limits on deductibility of retiree health prefunding that are supported under the tax code.

Increasing responsibilities under ERISA for fiduciary standards.

Securities laws are becoming more complex.

FASB accounting standards are even more onerous than the GASB standards because liabilities for these promises are flowing to the balance sheet now.

And, of course, we have the global competitive environment. Case in point here, the Big 3 automakers and the airlines all faced with legacy pension and retiree health-benefit promises are a significant burden to their nimbleness in this expanded market.

One of the next questions would be what do we expect for the future in the private sector? Will the pendulum of shifting risk to participants change? And the answer is both yes and no. It depends on what we're looking at here.

In terms of retiree health benefits, we're probably not going to see a shifting of the pendulum back. There is almost no incentive for the private sector to move back to making additional promises in this arena.

On the retirement side, we're probably not going to see a swing back to defined benefit plans. However, we are seeing a recognition -- and this is just an emerging trend -- that the current 401(k) plan design is untenable going forward. It has failed to produce enough security and adequacy for retirement income for the private sector to make that model workable going forward.

So instead, we're going to be seeing defined contribution plans that manage risks more effectively. So it's not a risk-shifting but a management of risk scenario in the private sector.

Looking at the public sector, finances are driving the discussion. That's the reason this Commission was formed. We have an environment where we have multiple stakeholders. And this is, again, that question of working in a political environment.

And your job and public policymakers' jobs is to make sure you chart a careful course between those twin dangers of Odysseus fame, where the monster Scylla and the whirlpool Charbydis, as he's coming back from the Trojan war, had to be negotiated very carefully.

What are some of the options for dealing with retiree health and funding pension issues, becomes the next question. The categories are pretty easily laid out: Increase funding, refinance the promise or decrease benefits. It's very likely that a combination at one level or another is going to be the order of consideration going forward.

Let me move forward into a discussion of how public policymakers may want to consider addressing the issue.

First of all, let's acknowledge that the

Commission is moving in the right direction, establishing the current state analysis, inventorying plans, measuring their funding liabilities, and testing the assumptions on which those liabilities are being established for reasonableness.

The third step is also being done, assessing long-term affordability. This is that particular -- a hard measurement of setting priorities: If these benefit plans cost so much money, how did this priority rank amongst all other obligations and objectives of the public sector?

The fourth step here, assessing short-term volatility, is one that needs a little more work. Can we handle the potential volatility of contribution rates going forward? The Commission has asked pointed questions of prior speakers. I think this is the right kind of discussion to be had, where knowing how liabilities behave under different economic and market conditions is going to be critical by using stress testing in particular.

Choosing the right course is the order of business of the day. And I'd like to suggest that one way to handle this is to go back to the beginning and decide where you want to go.

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(Dr. Ghilarducci left the hearing room for the day.)

MR. CRANE: Establish an appropriate retirement benefits policy. If you had the money, what would you like retirement income replacement to be, for example? What would you like retiree health subsidies to be? What sort of disability benefits, survivor benefits? What are your workforce attraction and retention issues that inform your plan design? What sort of social safety-net concerns have to be addressed as well?

Once you've identified the ideals, what you would like it to be, then, of course, there becomes a filter -- a more practical filter, a financial filter. What can you afford and what are the financial risks attached with making different kinds of benefit promises? And this particular second step involves looking at it from both the employer and the employee perspectives. Managing investment and funding rate risks, inflation and longevity risks, mortality and disability risks, annuitization risks, termination risks, and others that I don't have time to go into today, but are discussed in the following pages, are something that needs to be addressed.

Once you've set policies with regard to what risks exist, who should bear the risk and in what proportion, you're much better able to move into what we consider a risk-managed design. What is the right mix of defined benefit plans, guaranteed benefits, what kind of non-guaranteed benefits, and then what proportion, and the delivery mechanisms become hopefully more apparent.

I’m going to skip over a few pages here in the interest of time and move on to a discussion of, is an integrated strategy for retiree health and benefit pensions something that's possible? Certainly ideally, in our view, although not everybody's going to agree here, the integration of these two benefits is at least linked in terms of the funding mechanism. Retiree financial security, as indicated by a prior speaker, you can't talk about that if you don't talk about retiree health as well.

There are things to be gained through an integrated policy. Cost efficiency, tax efficiency, benefit compensation equity between employees and employee generations, workforce attraction and retention effectiveness, and taxpayer equity all are served.

Having said that, it won't be easy. Current benefit promises certainly limit flexibility. It's hard to move and change what legally cannot be changed in any respect.

So, therefore, the practical result here is separate strategies are likely to be necessary for new hires versus old hires.

The next slide is just a conceptual depiction of how this integrated strategy from the financing point of view might be looked at.

I won't go into that.

But I would at this point just conclude by noting that the rest of the slide deck that has been presented to you goes into some more detail about retirement and retiree health funding mechanisms and designs.

With that, I'll conclude my comments, Mr. Chairman.

CHAIR PARSKY: Thank you very much.

Gail?

MS. BEAL: Commissioners, Members of the Commission staff, thank you for allowing us to be here this afternoon.

I won't focus a whole lot of time -- my name is Gail Beal. I'm senior vice president with Keenan & Associates.

And my comments today will be providing you with information, perhaps answering some of the questions you had earlier regarding what are public entities currently doing, and perhaps give you some information there.

I will not go through these first three slides. Only briefly, just to let you know, my position is part of the one of the divisions, which is Keenan Financial Services, and we deal primarily with retiree and pension benefits.

As far as a background, you all know, there's a dramatic increase in health-care premiums, certainly since the late 1990s, when health-care benefits were much less expensive than they are now. And who could have foreseen what might happen? As a result of that, school districts are struggling to have money to not only pay current pay-as-you-go active premiums, but also providing for those future benefits.

GASB, while they are not necessarily a legislative group, they do not enforce anything, they do not necessarily require things. However, in the guidelines it does say that GASB does require governmental entities to report expense and liabilities on their financials. And part of the whole process was to get public agencies to look at health care, retiree health care, similarly to pensions, as you mentioned earlier.

So in their projections, they set up effective dates, they encouraged early compliance, at least as far as, as Ron said, setting some goals, perhaps some time-lines, and so there can be some long-term planning, getting bargaining units involved and so on.

When Keenan first started looking into research on the programs, we did a survey with clients and other valued people that we knew. And some of the things that came out were what was most important to public entities in the state of California?

One was perhaps a way to reduce the liability, since funding is not required. Maybe there's a way to reduce it without funding.

Developing a GASB compliance plan that is comprehensive that includes GASB 43, as well as 45.

Manage fiduciary liabilities. Since we are in San Diego, that is kind of a hot button down here, as far as people who are personally liable for decisions. So how can any investment decisions be managed from a liability standpoint?

And certainly improving investment earnings. Actuaries throughout the state of California will contend that in the actuarial studies that are done, typically they'll use a 5 percent discount rate. If the investment earnings are getting 7 percent, that could increase the liability by as much as 30 percent.

And then certainly I think we've heard it today, controlling the future benefits and maintaining the generational equity. Also a noted actuary has stated that any single percent increase in the medical trend could increase the liability in the actuarial study by as much as 14 percent. So they're huge numbers that we're perhaps dealing with.

GASB 45 does require -- and they also use “require” -- the valuation of financial reporting. They do not require funding. There are certain consequences for not funding that are not necessarily in anyone's control, especially GASB's. However, they do not require the funding.

They basically are requiring a change from cash to accrual accounting. And what that does, in another form of verbiage, would be going from a promised benefit to more of a guaranteed benefit. If those funds are in place, then that could become a guaranteed benefit.

GASB 43 creates the substantive plan. The Phase I districts have already become effective for both. GASB initially said the substantive plan needed to be prepared one year prior to their GASB 45 effective date. They have since come back and said once the trust is set up, GASB 43 needs to be in effect.

The key elements in the substantive plan to meet the “understanding of the parties” are specifically:

Specify the benefit design in detail. Over the years, there have been many handshake agreements that have never been documented, they've never been put in any -- it's just institutional knowledge that is relied upon. So this becomes something where everything is documented.

It details eligibility; the employer and employee cost sharing, if there is; relevant sections of the collective bargaining agreements and/or those handshake agreements. Certainly any communication that has occurred. And it does require that they go back, historically, to when benefits were first offered. And that has to be documented going forward. And then any changes in those.

And it is a live document, so it's something that needs to be updated on an ongoing basis. I would say the overall definition of what needs to be in this plan, the book, the binders, is anything that's understood between the employee and the employer.

As far as how our public agency is responding, Keenan has put together a program. And just to give you some ideas on what we have seen so far, our database shows that there's about $700 million set aside by 200 California public agencies. So some have earmarked funds.

Currently, we have 20 irrevocable trusts that are being implemented and 20 substantive plans being implemented.

There's an additional 15 trusts and plans that are in process. So in addition to the two that were mentioned earlier, those that we know of who have currently funded -- we have others that have set up the trust -- but would be Orange Unified, Long Beach Community College, Val Verde Unified, Sierra Community College, Pajaro Unified, just as an example.

So I think the recommendations are: move slowly, take your time, get your goals, get your objectives together.

But I think as school services has articulated many times, don't just do nothing. Just plan, plan ahead, see what will happen. And in the meantime, look at some cost-reduction strategies. They may or may not include eligibility audits, perhaps retiree medical opt-out plans. If a spouse already has a plan, maybe an employee could opt out.

Two-tier early retirement plans that work the same way: A higher benefit if you opt out of the retiree medical.

Maybe a retiree medical trust. That's

something new, but going forward, maybe something that's viable.

And then just consulting, generally speaking, on what the benefits currently are.

And finally, looking at those investment rates of return, how can that ultimately lower the overall liability?

Thank you.

CHAIR PARSKY: Thank you very much.

Questions?

John?

MR. COGAN: I have a question on integration of pension and health-care prefunding funds, let's say.

On the administrative side, I see the clear benefits of integration. I'm not so sure I understand fully how much integration would take place or how much would be optimal. That is, in some sense, we're talking about a retirement package of income and health that individuals should be given by their employers and funded, in part, by their own contributions. If there is a shortfall in a health-care fund, the likelihood is that's going to be made up for in some way by an increase in the employee's or the retiree's contribution to the health plan. That's like a reduction in their disposable income, which is no different than a cut in their pension benefits.

And so when I think about it in the way that one of our previous speakers talked about retirement security, I see both being sort of -- I see an argument for full integration of the health -- a prefunded health and a prefunded pension benefit.

I wanted to get you to comment on what you think the optimal level of integration should be.

MR. CRANE: If I may just go ahead and start that.

One way to look at it is if you had enough money to fund both, there's still the question of, for an individual, what is the best outcome.

Regardless of, first of all, establishing, for example, that if you assume that retirees need 70 to 85 percent income replacement ratio, and you have enough money set aside for that, if you establish that retiree-health costs on average -- this is just throwing out a number for discussion’s sake -- that a Medicare retiree is going to need roughly $200,000 to $220,000 to set aside to fund their cost through age 90, if that's the target, then the question is, how do you get there?

And the employer might have so much money to put towards those combined objectives, the employee might have so much money to put those towards those combined objectives. There might be Social Security benefits, there might not. And once you've got those sources, there's a way to put those together, and say, "How does one plan, on an integrated basis, from the funding available," and should the employer then say, "We're going to fund so much in total of the entire retiree pension and retiree health, employees have to fund the balance." That might differ from employer to employer, from state to county to city. And, therefore, you end up needing some sort of different flexible solutions to get there. By having flexible plan designs then, retiree medical pension and personal savings, voluntary savings, you allow, as best as possible, the employer and the employees to react to these differing situations.

Then ultimately -- that's kind of at the plan-sponsor level.

Then the flexibility needs to occur on an integrated basis at the employee level, saying, "How do I manage the rest of this situation going forward?" It's like financial planning on a holistic basis: Do I have a house, can I sell that? Do I have an inheritance from other resources? It's an optimization model that we're speaking of here in terms of integrating this.

So there are two components here: Institutional solutions. You have the institution, the employer coming together, and coming in with some cohesive, holistic financial planning, retirement planning, and delivery products and services to make sure that employees end up in the right place.

I don't know if that answered the question or not, but that's kind of the high level overview.

MR. COGAN: Right, right.

Gail?

MS. BEAL: I would just approach it from maybe a different angle in terms of the employee and the employer. I think with the whole process, with GASB, with what perhaps is happening and what's going to happen, we're very early into the process. So, again, I think it goes back to what we've seen with many school districts, and that is the bargaining units coming together with the administration to look at the broad picture, whether they're looking at total compensation and integrating the benefits with the pension and with the salary increases, and discussing it not only for retirees, but also for actives, so they can plan going forward.

So I guess overall my comment would be, we're still a little early. I'm not sure we have a really clear picture other than, as Rod said, kind of the high-level overview of what it might look like.

But when you get down to the nuts and bolts, I think there's some work to be done.

MR. COGAN: We have to make some recommendation on whether we're going to prefund health-care benefits at all. And if we were to do that, then we'd have to make a recommendation on the structure of the fund. And so one question arises, would you have a completely separate fund for health as opposed to pensions? Would you merge them? Would you allow financial exchanges between the two?

Any thoughts on that?

MS. BEAL: From my perspective at this point, with the knowledge base that I or we have as a firm, I would say, for now, keep it separate. It's a lot easier to bundle it eventually than unbundle it eventually, at least from our experience.

So I think, again, it's starting slow in a lot of areas. But perhaps that's where it would go. But let's see what works out in the investment world.

MR. COGAN: That's good advice.

MR. CRANE: You've actually asked a very difficult question, because the current tax environment pushes you towards separate funding solutions.

On the other hand, we've got one funding source, and we also have, as you indicated, Gail, that the future on the retiree health side is rather cloudy. And other speakers today have said the same thing.

Going forward in making permanent long-term decisions with regard to retiree health care is a bit dicey at this point. On the other hand, doing nothing is not permitted, either, as a good public policy position. So something in between is probably going to be the order of business. Some prefunding using existing tax code, possibly moving towards getting a more rational tax-code position with regard to funding these benefits is in order.

CHAIR PARSKY: Great. Thanks very much.

Dave?

MR. LOW: With regard to your last comment about doing nothing is not an option. We understand that they are required to do an actuarial study and report. But Marty Hittelman made a very strong case for that being the end of the line and continuing a pay-as-you-go system. And I know that over in some states, such as Texas, they've total rejected the GASB provision.

So let me get your response and reaction to that.

MS. BEAL: As far as the comments on the actuarial report being done -- and Marty's comments were true. However, GASB has also said based on the size of your district or your city or county, you have to have an actuarial study done every two years or three years. So it's one of those things where it would have to be updated periodically to reflect any changes. I would agree that if it was one study for a 30-year amortization, that would be a problem.

I think disregarding GASB, again, there could be some dangers there in terms of -- our experience has been when we've had entities go back East to float a bond, the first thing that's asked for is, "What is your substantive plan?" And if you have those binders to hand them, you know, it may not increase the credit rating, but it certainly has been the experience of some districts where it's maintained. So, you know, I would say that the actuarial study is important.

I think the pay-as-you-go, if you look at some of these studies, increases by as much as 27 to 32 percent over ten years, where entities' budgets are only increasing, what, 3 percent, maybe 4 percent. So do you have assets to offset that liability, and how do you balance that?

MR. LOW: I guess the question that Marty was bringing up is that if you're on a pay-as-you-go basis, the amount of money you're putting out is the amount of money you're putting out for the premium for the retirees, plus whatever cost-of-living or inflationary rate there is in the subsequent years, as opposed to in some cases of prefunding, you're actually setting aside a much larger amount of money, which bond houses also look at the amount of money you have to pay off the bond.

MS. BEAL: That's right.

MR. LOW: So there's an offsetting impact.

And I'm interested in, you know, your response to that.

MS. BEAL: I think there is -- and I'll let Rod comment as well -- but, you know, I think a lot of what districts are doing is in the study, there's an annual required contribution that I think should actually be the actual recommended contribution. But GASB does call it the required contribution. And most entities are not fully funding that annual required contribution. They're funding a little bit to show that they are doing something proactive.

As far as your comment as to how the bond companies and the rating agencies look at financials to offset that, I think it remains to be seen. Again, I think we're early as far as what's ultimately going to come down in terms of final comments from any of the major bond agencies.

CHAIR PARSKY: Rod?

MR. CRANE: My thoughts largely parallel those of Gail's. I would just only add that GASB didn't do this in a vacuum for no reason. There are substantive issues and policies behind it. And some of the reason why we're here, this is just what they wanted to do: They wanted a light and a discussion on the topic.

You may come up with a public policy that retiree health prefunding is too uncertain to engage in a massive change from current policy, from pay-as-you-go, for all the reasons the previous speaker has identified. I don't have a position on that. But the conversation needs to be had. And not having the conversation says something to the markets as well.

MR. COTTINGHAM: Just to continue on that, though, if your decision was, under GASB as it is now, that you continued the pay-go process, and I think in the analogy we're given which is, right now your pay-go may be $25 million a year and under GASB they would project it at $65 million, then are you actually -- by only doing your pay-as-you-go, are you actually increasing your unfunded liability?

MS. BEAL: You absolutely are.

In ongoing actuarial studies that are done, if there's no funding, the actuary has to assume there was, and attach to that liability, another interest rate.

So what happens over the period of years is, there is compounding interest to where your liability increases dramatically.

And so if you're just doing pay-as-you-go, GASB doesn't look at that as compliance in terms of any prefunding.

MR. COTTINGHAM: But if your pay-as-you-go was actually covering your ARC, would GASB consider that to be covering it and diminishing the liability?

MS. BEAL: I have yet to see that happen. If that were the case and it was being funded in an irrevocable trust, set aside explicitly for retiree benefits, then, yes, GASB would treat that as complying.

MR. COTTINGHAM: All right, okay.

CHAIR PARSKY: But it would have to be set aside?

MS. BEAL: It would have to be set aside irrevocably, yes.

CHAIR PARSKY: Okay, thank you both very much.

MR. LIPPS: Gerry, Just a quick question. It sort of ties together a bunch of these pieces.

Rod, you mentioned a little bit earlier that you believe that for a public agency to make a long-term decision now with respect to funding retiree health, it might be a little bit dicey. I think "dicey" was the word that you used.

But you also advocated that putting money aside now still is not a bad idea. And yet we heard Gail presented some information that there are about 20 districts in the state that are already beginning to fund their retiree benefits through an irrevocable trust.

Would that be a little bit premature at this point, do you think, in terms of putting it into an irrevocable trust when we don't know how things are going to shake out for the next year or two?

MR. CRANE: Mr. Lipps, I can’t answer that question without knowing the nature of the benefit promise in the first place. I think that's one of the messages, I think, in my presentation I would want to emphasize.

If you don't have a benefit policy in the first place, what do you want to provide? What is the target? You can't come up with a funding policy for that. And the decision of how much to put into an irrevocable trust becomes an impossible decision to make at that point.

The two things are -- they're joined at the hip. You move forward with your decision-making, first, by deciding what the needs are, how much can be covered from an employer perspective, from a public-sector perspective, how much you want to leave to the employee, if any; and then come up with a funding policy to fit. Is it a defined benefit promise, is it a defined contribution promise, is it a combination of both? All of these things.

And I am not advocating any particular solution here. But unless you've first decided what your promise is, putting aside money in an irrevocable trust becomes a decision that is dicey.

MR. LIPPS: Thank you.

CHAIR PARSKY: But just to complete the loop there, inherent in what you're saying, though, is that if you do have a policy and you can define it, an irrevocable trust is a way to ensure that the promises will be met?

MR. CRANE: There are excellent public policy reasons to put that money aside. For all the reasons that apply to pension plans apply here as well.

CHAIR PARSKY: Thank you both very much. I really appreciate it.

MS. BEAL: Thank you.

CHAIR PARSKY: Okay, with the permission of my Commission Members, we'll pass on the break and move to our last panel.

MS. BOEL: There's coffee behind you.

CHAIR PARSKY: Don't all of you get up at once, though. One at a time.

But go ahead, John.

This panel is under the heading "University Systems."

Okay, Judy, are you going to be first? Is Judy first?

MS. CHAPIN: Sure.

CHAIR PARSKY: I know Judy well. So she'll start us off on a good basis, I'm sure.

Okay, Judy, proceed.

MS. BOYETTE: Okay, thank you very much for the opportunity to participate.

I am Judy Boyette, associate vice president of Human Resources and Benefits for the University of California. And my department has responsibility for systemwide retirement and health and welfare benefits, HR policy, and labor relations for about 188,000 faculty and staff and their families, and over 45,000 retirees and their survivors.

Given the time that we have today, I'm only going to briefly summarize some key points.

I've given a more complete version of testimony of the University's concerns, these areas, and it's submitted and posted on the Web site. I'm going to try to hit the highlights for you.

The University of California has a retirement plan that has been the University's defined benefit pension plan since 1961. The retirement plan has been fully funded for 20 years and non-contributory for the past 17 years. It's an important part of our overall employment package, along with retiree health plan. It produces a retirement package that's actually well suited for some of our key employment objectives, just to attract and retain the highest quality faculty and staff and keep them working with us for their career.

Due to earnings on our pension assets that have on average exceeded assumptions, the University's employees, as well as the University and the State of California, have enjoyed a holiday from having to contribute since the early 1990s.

In fact, over 50 percent of our current members have not made a contribution to the retirement plan.

There are contributions that are going into a defined contribution plan in lieu of contributions to a retirement plan, that is an invested account that the employee controls.

We do believe, though, that a contribution holiday is not sustainable over time. The costs of future benefits each year are roughly 16 percent of pay, or over a billion dollars. And no money is currently going into the plan to defray those costs.

Although we're currently funded above 100 percent and our plan's investment return for the last year is preliminarily at about 18½ percent, mirroring what you heard earlier today that it's been an outstanding investment time, we don't believe it's realistic or responsible to assume that we could sustain our plan indefinitely without contributions. As everyone knows, investment returns could vary dramatically year by year.

Although our plan is fully funded today, it was about 104 percent as of the last valuation date. And we believe though we should be making some contributions on the benefits accrued today, not simply paying them out of surplus. This past year, though, we were unsuccessful in obtaining state funding for the portion of an initial 2 percent employer contribution related to state-funded salaries. And as a result, we've delayed the implementation date for contributions for the plan.

Our pension plan will remain fully funded in the near term. However, we do need to continue working on how to obtain funding to sustain the full funding of our plan.

I'd also like to talk about UC's retiree health benefits. The retiree health program offered by the

University is an important -- very important recruitment and retention tool and an important financial security benefit for our members.

And I would add that it's especially important to our employees because the UC Medical Centers and our clinical physicians are major providers of health care; and they are, in fact, among the top providers of health care for our employees. And I think if I had to explain to our employees and retirees that we were not offering them medical at our medical centers, I would not want to show up for work that day.

In 1990, the University did implement graduated eligibility, whereby new employees generally have to have ten years of service to qualify for any retiree medical benefits. At ten years, UC pays 50 percent of the current employer contribution towards the total medical benefit premium costs, and that increases with each year of service, up to 100 percent of the employer contribution with 20 years of service.

Our current requirements are different than some of the other public entities in California that require only five years of service to qualify for retiree medical benefits.

As you've been hearing a lot about, the recent governmental accounting changes, in combination with continuing health-care cost increases, have made our long-term costs in the retiree medical area more visible. And although our retiree health benefits are not vested in the same way that our defined benefit pension plan benefits are for our employees and it is communicated differently from the pension plan, the University is committed to maintaining a sustainable retiree health benefit program.

We have established a current health-care trust to facilitate our pay-as-you-go funding, and it also will provide us a vehicle for any prefunding we might be able to do in the future.

We have been analyzing prefunding options and potential health program changes that would manage future costs. But any changes would have to be in such a way that we would maintain a competitive benefit for our retirees.

Our GASB 45 analysis shows our annual pay-as-you-go cash costs for current retirees is about $205 million a year, our annual required contribution would be about $1.3 billion to $1.4 billion a year, and our unfunded liability will be about $11 billion to $12 billion.

It's very important also to remember that the restart of employee contributions to our pension plan and any changes to our retiree health program are subject to collective bargaining for our represented employees and the University's shared governance consultation process with the academic center.

Now, really the main focus of my remarks, I wanted to be able to share with you how UC is different from many other public employers in California due to our varied businesses and their varied funding sources. We have instructional campuses and hospitals, research facilities, clinical medical centers, the DOE labs. And within each of those, there are complex and differing funding sources, some of which are variable and -- this is what's very important -- not permanent in nature.

One of the speakers mentioned that this was important because we have one funding source. I want to tell you for sure, UC does not have one funding source. Sometimes it's hard for me to even count the number of funding sources. They vary by campus, with some having a much higher portion of revenue from federal contracts and grants, for example, than from other sources and from other campuses.

In 2005-06, for example, if you compared the Santa Cruz campus and the San Diego campus, excluding the medical center even, Santa Cruz received 28 percent of their revenue from state appropriations; San Diego campus, 19 percent of their revenue from state appropriations. Tuition and fees was 24 percent of revenue at Santa Cruz, and 12 percent at San Diego. For federal contracts and grants, Santa Cruz received 19 percent of their revenue from that source, at the San Diego campus, it was 34 percent.

They're similar in the testimony I provided to you. I gave you some systemwide numbers. I think it's probably surprising to many people that only 17 percent of the overall funding for UC is from State General Funds. The remainder is from varying sources.

We believe we should be capturing the costs today for the pension and retiree health liabilities that we incur today. We should be collecting contributions to fund those obligations as they are incurred during the limited term of the contract or grant. However, under federal funding rules, we cannot charge contracts and federal contracts and grants unless we're charging all funding sources. That means we would have to receive support from state funds and other self-sustaining enterprises: Our food services, our dorms, the parking structure that you paid your $6 for today. Self-supporting.

And it should be $6.50, so we can fund our retiree medical.

Sorry, that was ad-libbing.

CHAIR PARSKY: We'll record that.

MS. BOYETTE: Failure to assess, for example, our contracts and grants for the projected costs of the post-employment benefit liabilities incurred during the duration of those contracts means that the ability to obtain funding in those contracts and grants is gone forever. If we do not do it while the grant is open, we won't be getting the money.

I want to make sure that you understand that for UC, the pay-as-you-go retiree medical option may not work, when about 75 percent of our payroll is based on non-state supported, either self-supporting activities or some of our institutions' very significant federal contracts and grants. Deferring the costs in the future could impact our ability to effectively compete for future contracts and grants, as well as the affordability for students. Having to fund significant future liability through increased fees has the potential to adversely affect enrollment and could put the University's -- and therefore California's -- economic competitiveness at severe risk.

We do have unique competitive labor market considerations. We compete and recruit for talent in diverse labor markets. We need the flexibility to continue to maintain and fund the programs that are important to compete in academic positions, in medical positions, research positions, and for our staff, among other large California employers.

We are aware that funding our current and ongoing liabilities is a critical priority. We've been in broad consultation on these issues for some time; and we will continue to. We look forward to finding solutions.

Because of our complexity and diverse needs, the main point that I'd like to leave you with is that we need to maintain flexibility. It's critical to our ability to continue to accomplish our mission and contribute to the State.

Our faculty and staff are incredibly devoted and hard-working people. They care deeply about the University. They work proudly and tirelessly to preserve the education our students receive, the care that you and other people in California receive in our hospitals. They are the people who maintain our reputation as innovators and as national leaders in California. They deserve a secure retirement and nothing less.

We share the concerns that this Commission is struggling with. We want to offer whatever help that we can give to evaluate these very serious issues. And I want to be sure that you know that if there is any information that you need from us, we're more than willing to provide any information that you might need.

CHAIR PARSKY: Thank you very much, Judy.

Pam, do you want to go next or Lakesha?

Go ahead.

MS. HARRISON: Okay. Good afternoon. I'll try to make this quick.

I don't think I'm going to skip because there's a lot of important information here, but I'll go as quickly as possible.

My name is Lakesha Harrison. I'm the president of AFSCME, Local 3299. We represent 20,000 of the University of California employees from the lowest-paid food service worker to some of the highly specialized tech positions in the hospital.

Myself, I am an LVN. I'm a licensed vocational nurse, so I give your shots when you come in the hospital, wrap your wounds, and treat you real good when you get there, despite my pay.

So I just want to talk a little bit about the retirement. Some of the best practices at my teaching hospital, UCLA, Santa Monica UCLA Medical Center, we try to follow best practices to assure that patients receive the best care possible. And today I want to talk about some best practices on the pension and retiree health and where myself and the workers that I represent see UC fitting in.

On the pension, UC has followed best practices in certain areas. Extraordinary investment returns in the past have kept the pension over 100 percent funded, as Judy said, for many years providing essential retirement benefits at low cost. The pension is a key tool for recruitment and retention for UC, along with health benefits since UC's wages significantly lack marketing comparators.

This situation is dire for some jobs in some departments, such as radiology and nursing, where UC is known for training recent graduates who then move on after a year or two to other hospitals with higher pay and comparable benefits.

I think I could speak for most UC employees when I say that we value our defined benefit pension and our retiree medical benefit. And we will do what it takes it continue -- whatever it takes to continue receiving them at their present form or in a better form.

Wages and pension at UC and its market comparators. Since wages, health care, and pensions are interrelated in terms of total compensation, when we look at UC's pension benefit, we also need to look at the wages. While UC provides a relatively generous pension benefit formula, the same cannot be said for its wages. UC's comparator employees generally offer higher wages and defined benefit pensions. In some cases, UC has a higher pension formula which does not offset the lower wages that employees earn during their work life, but does improve the pension benefit. However, the higher base pay at UC's competitors boost their pension benefit even when the formula is lower.

I would like to present two examples of compensation at UC Davis campus and the UC Davis Teaching Hospital. One involves a campus-based service worker, a senior custodian. The other involves a technical patient care worker, a principal radiology technologist. And I think you guys have the things in front of you.

So for custodians, UC Davis wages are 32 to 52 percent lower than at the local community college with a similar pension formula. Service workers at UC earn lower wages than their counterparts at California community colleges. Human resources managers at UC say these gaps affect recruitment and retention.

The following table compares the senior custodian classification at UC Davis with a custodian classification at Los Rios Community College District in Sacramento. Starting pay at Los Rios Community College is $33,471 per year, 33 percent, or $8,289 more than the $25,181 earned by most starting custodians at UC Davis. The top pay for custodians at Los Rios is $46,500 per year, which is 52 percent or $15,618 more than the highest-paid UC Davis custodian, earning $30,882, which is the highest paid custodian at UC Davis.

The lowest-paid Los Rios custodian earns a $1.24 more an hour than the highest-paid UC Davis custodian.

It should be noted that UC has a range wage system with no guarantee of movement through the range, while Los Rios Community College District has a step system, with annual movements up the steps.

Custodial pensions. Most community college classified employees are in CalPERS. UC and CalPERS have similar pension formulas. The pension formula at UC is 1.8 percent at age 55, increasing to 2.5 percent at age 60. Los Rios Community College District has a 2 percent at 55, which is just 2.5 at 63.

UC's low wages and similar pension formula means that UC workers receive lower wages and lower pension for the same work as community college workers.

UC management is seeking to require that employees pay 5 percent into the defined benefit pension, a matter that is subject to collective bargaining for represented employees at UC, including my members. Custodians and other service workers cannot afford to pay more for the retirement.

At UC, as Judy pointed out, there has been a 17-year contribution holiday for the pension, with no employee or employer contributions into the pension since 1990. The UC pension has been funded exclusively from fund earnings, though employees are required to pay 2 percent of the covered compensation to a defined contribution retirement savings plan. So employees do not really get to enjoy a holiday. Our money never came back to us, it just got shifted. And although Judy said we can control the plan, we can't control and put the money back in our pocket. We can just say, “Go to a mutual fund” or “Go to this,” but we cannot get that money and put it in our pocket. But UC was able to -- the 6 percent that they were paying in 1990, they did not put into a separate plan or match the 2 percent that we had to put into a plan or anything. The money just went back. So it was truly a holiday for UC but not for workers.

So many California community colleges -- community college employees contribute 7 percent to their pensions, but their relatively higher wages offset this paycheck reduction.

So for radiology technologists at Kaiser Sacramento hospital wages are 30 percent higher than at UC, but UC’s pension formula is better. So the table you have in front of you compares rad techs at UC Davis Teaching Hospital with rad techs at Kaiser in Sacramento. This job class was chosen because it is typical of the hard-to-recruit-and-retain technical classifications at UC Medical Center. For the purpose of comparing pensions, wage levels were chosen that would reflect where employees would be after 20 percent of service.

Wages for Kaiser radiology techs are 30 percent higher, as I said. At UC, a principal rad techs earns $35.11 an hour, compared to the $45.45 at Kaiser. This means that a UC worker doing the same job as a Kaiser work earns $21,590 less per year than at Kaiser.

So on rad tech pensions, UC's better pension formula partly makes up for UC's low wages when compared to Kaiser. Kaiser's pension formula tops out at 1.5 percent at 65. To supplement the lower pension, Kaiser is improving its retirement program by adding a 100 percent match of the employee contribution to the retirement savings account, up to 1.25 percent of the employee's salaries starting in 2008.

As I said before, UC management is seeking to require the employees pay 5 percent into a defined benefit pension. At Kaiser, the pension is fully employer-paid, with no employer contribution. And it should be noted that since the Kaiser rad techs earn $21,590 per year more than at UC, they are comparatively more able to devote money to the retirement system than UC workers are. So one-size fixes do not fit for all employees.

There is much talk about finding a one-size-fits-all solution for pensions. Keith Richman has just introduced a truly draconian measure to reduce pension benefits that would hit workers at UC very hard. As I just outlined, our wages trail comparable jobs, our pension benefits keep us working at UC, but not under the terms of the Richman initiative, with low wages and drastically reduced pension benefits, we'd have absolutely no reason to stay at UC.

Wages and pay at UC and at schools and public agencies around the state are collectively bargained. This results in a wide range of wages and benefit packages. It is not possible to find a one-size-fits-all solution to pension benefits, especially for workers who are at the lower end of the wage scale. We are the ones who can least afford the benefit cuts and who would suffer the most.

So best practices on pension governance. UC also does not follow best practices in another area relating to the pension, and that is on internal governance. The other state public funds, CalPERS and CalSTRS, have governance structures and policies that protect the interest of the plan participants with policies and procedures that guarantee fiduciary responsibility, transparency, and ethical behavior. UC falls short in this area.

CalPERS and CalSTRS are both governed by a board of trustees that includes employees and retirees elected by plan participants and appointed employer representatives. Funds with this type of joint governance have been show to provide better benefits for workers, are generally financially healthier, and are proven to be far more secure than unilaterally managed plans.

The UC pension plan is governed exclusively by the Board of Regents with no employee input on substantive issues. At their bimonthly meetings, the Regents addressed pension issues only infrequently and only as to the most pressing issues. Five UC unions, two UC Regents, and the Senate Education Committee have all gone on record supporting the principle that UC employees should have representation on the board of their own pension plan, but still UC has made no changes.

Without the employee pension trustees at UC, the Regents have chosen to increase retirement benefits for executives only. It has also paid scant attention to internal governance policies that protect the interests of the plan participants, reduce conflict, and ensure open meetings and transparency in general.

In contrast, CalPERS and CalSTRS follow best practices with regards to their internal governance policies. They have governance committees that have created a comprehensive set of policies. CalPERS' comprehensive rules range from preventing board members from having contact with anyone bidding on a CalPERS contract, to strong conflict-prevention language. CalSTRS also just went through a long process to review and strengthen its already strong policies. Its rules include preventing undue influence by board members on staff.

Recent disclosures of conflict of interest on the UC pension suggests that UC would greatly benefit from a comprehensive review and reform of its internal governance policies. Several news outlets have recently written about potential conflicts of interest between investment advisors to the UC Regents and investment management companies. One Regents advisor failed to disclose that he had a financial interest in a company that was given a contract to manage UC pension equity funds, and also failed to disclose that his daughter's company was bidding on another contract to manage UC money.

In response to the media attention, the UC Regents have unilaterally proposed changes to their conflicts policies that still do not call for public disclosure and that do not prevent conflicts and the appearance of conflicts from occurring.

Of even greater concern, in 2000, the Regents chose a new investment consultant for the plan who had political ties to one of the Regents. Since that time, the plan's investment performance has sunk from the top quarter of comparable plans nationwide to the bottom quarter of such plans. These developments super led state legislators to introduce a resolution calling on the Regents to create joint governance of the Board.

Best practices for retiree medical benefits. The retiree medical benefit we have at UC is very important. And like pension, it's why a lot of us stay at UC, despite the low pay.

At UC, the employee and the employer share the cost of monthly health-care premiums. Each year, UC has been shifting more of the costs of health care on the employees. Under UC's pay band system, higher-paid employees pay higher monthly health-care premiums than lower-paid employees, though the lower-paid employees pay a greater share of their income for health insurance than higher-paid employees. Lower-paid employees are in pay band 1, with higher-paid employees in pay band 4.

The way retiree medical works at UC is that if we worked at UC for 20 years or more, UC continues to pay the employer's share of the monthly premium when we retire. If we worked at UC for less than 20 years, we also have to pay part of the employer's share, up to half if we worked at UC to ten years. There is also some benefit for older workers who worked five to nine years and retire at UC.

Upon retirement, employees continue to pay the employee's share of the monthly health-care premium. All employees pay the pay band 2 monthly premium rate for retiree medical care, which means that the lowest paid employees have to pay higher monthly premium rates in retirement than they did as employees, while higher-paid employees pay less.

We know that the retiree medical liability is large at UC. As UC tackles its problem, employees want it to follow the same best practices as those that apply to pensions, we need the following for retiree medical at UC:

A guarantee. A guarantee of retiree medical is an important recruitment and retention tool. That's why retiree medical benefits need to vest like pension benefits.

Prefunding. Prefunding is the best way to ensure that the benefit will be there in the future.

Good governance. Joint labor-management governance is needed to safeguard retiree medical trust and ensure that the funds are managed in the interest of plan participants and beneficiaries, just like the pensions.

As a final note, I would like to point out that UC has not contributed a dime to its pension during its 17-year contribution holiday. If UC had had the foresight to pay even 2 percent into a trust fund for retiree health during the contribution holiday, it would have helped lower the retiree health liabilities now. So that surplus could have been used much more wisely.

In summary, UC's pension and retiree medical benefits are important recruitment and retention tools for the University, especially in view of its low wages. To follow best practices that help ensure strong benefits, financial health, and pension security, UC must create a jointly governed pension and retiree health board of trustees with elected employee representatives and appointed employer representatives. Such a board could help UC follow the internal governance best practices that are the norm for other state public pension funds.

Thank you.

CHAIR PARSKY: Thank you.

Pam?

MS. CHAPIN: Thank you.

Can you hear me okay?

CHAIR PARSKY: Yes.

MS. CHAPIN: My name is Pamela Chapin; and I'm the senior manager for benefits and HR programs for the Office of the Chancellor for the California State University.

The California State University is a leader in high quality, accessible student-focused higher education. With 23 campuses throughout the state, 417,000 students, 46,000 faculty and staff, the CSU is the largest, the most diverse, and one of the most affordable university systems in the country.

The CSU operates in a complex regulatory environment. It is its own appointing authority, subject to some, but not all, state and federal laws pertaining to employment. It is governed by multiple California codes and the applicable sections of the California Code of Regulations that pertain to CSU. The CSU currently has 12 collective bargaining units and four unrepresented employee categories. The CSU is not subject to civil-service regulations.

We're a CalPERS-covered employer. And as such, we are enrolled in the defined benefit plan, and also are covered by the health-benefit program that CalPERS offers.

It is important for the Commission members and the general public to understand how the mission of the CSU impacts the economic growth of the state of California and offers a way for its citizens to improve their quality of life.

And I won't go through all of the things that I put in my testimony, to save a little time. You've been here a long time.

The California State University is a leader in providing access to quality education. We are the country's largest four-year university system, the most diverse -- minority enrollment tops 53 percent -- and the most affordable in the nation, comparable to other public universities nationwide. We graduate 82,000 students each year into the California workforce, including more Hispanics, Native Americans, and African-Americans than all other California universities combined.

The CSU is vital to California's economic prosperity. A more educated workforce leads to a more higher-paying, knowledge-based job, which in turn leads to more growth and benefit for the entire state as well as for the regional and local communities.

Investing in the CSU is an investment in California. When a state makes an investment in the university education of its citizens, the state as a whole, along with its regional and local communities, receives a lifetime earnings boost. CSU-related expenditures create over $23 billion in economic impact and support over 207,000 jobs in California. When enhanced alumni earnings are taken into account, the CSU's impact reaches $53 billion.

The CSU generates more in tax revenue for state and local governments than is provided for CSU in direct annual state support. In effect, the CSU pays for itself.

To offer the educational opportunities and wide-ranging benefits the CSU provides to the state and its citizens, it takes the dedication of thousands of CSU employees to make it a reality. The CSU recruits throughout the country to attract talented individuals with the requisite knowledge, skills, and abilities to fill faculty, staff, and administrator positions. After the initial hiring, the challenge is not over. In order to be competitive, the CSU must offer a total rewards package to its employees in order to motivate and retain them. As with other California employers who recruit nationally, the CSU is challenged by external issues such as the high cost of living in the state. The CSU has to find other incentives to encourage individuals to come to the CSU.

The CSU has 16 different employee categories, encompassing a wide range of jobs, such as police officers, faculty, physicians, management, custodians, and presidents. The key demographics for the CSU as they relate to the task at hand are: The number of employees that are eligible for CalPERS health benefits are 37,020. The number of employees enrolled in CalPERS membership, which is the retirement system, is 37,574. The current number of CSU retirees who are enrolled in CalPERS medical plans are 23,282.

In the past, when the State suffered economic downturns resulting in significant state budget deficits, the CSU struggled with budget cuts in consecutive years without funds for general salary increases for employees. The lack of additional salary funds resulted in salary rates for many of the classifications within each employee category, falling below market when compared to comparable educational institutions.

Fortunately, one of the selling points for CSU employment is our benefits program, of which the CalPERS retirement and health benefit programs are key components. The 2 percent at 55 retirement formula for the majority of our employees, along with the medical benefits that include a retiree medical plan, allows CSU to compete with other major universities and employers to attract quality candidates.

It is imperative to the continuing success of the CSU to retain the level of retirement and health benefits to ensure the CSU's ability to recruit and retain quality employees necessary to maintain the educational mission and excellence of the CSU.

Thank you.

CHAIR PARSKY: Thank you very much.

MS. CHAPIN: One thing. When I was asked to participate in this, I received multiple suggestions on what you wanted to hear. And based on that, I put together this presentation basically by myself. But one of the things I wanted to do and share with the Commission members on how important CalPERS medical and retirement benefits are, I have included to add to your packet a recruitment tool that we use that outlines our benefit package and the CalPERS program is in here. So

I thought it might be interesting for the Commission members to review this.

CHAIR PARSKY: Thank you.

Judy, we've heard from a number of presenters overall that the concept of creating a contribution holiday is not a wise policy, looking back or looking forward.

How do you feel about that in the context of UC as one of the unique entities that created such a holiday?

MS. BOYETTE: Fortunately, I was not here so I had nothing to do with it.

I think what we would need to do at this point, I think as you've heard a lot of people say today, I feel, from a public-policy standpoint, we need some trigger points, some agreement. At least I'd like to hope there could be at some point, that we could all agree on whatever that point might be, where you could trigger decisions about things without having to get into massive debates every time the market goes up or down. It has caused a problem.

And as Lakesha mentioned, frankly, if we had continued to make contributions or even into some of the other areas, we would probably be in a different place today, although we're in a pretty good place compared to some other institutions.

But I guess I would not personally -- speaking as Judy, not as the University of California -- I would never be recommending a holiday from anything anymore.

CHAIR PARSKY: Yes?

MR. PRINGLE: Ms. Harrison, just a real quick question.

Thank you for practical suggestions that you have as a part of your presentation. One of them is good to see, and it's a little contrary to other things we've heard today, and that is your support of prefunding of any of those medical benefits.

Is that a position of AFSCME or of your local or of you individually?

MS. HARRISON: This is what we found in our research. If you ask me, has AFSCME taken an official, like a voted-on position, we have not done that yet. But the researchers we've hired to find out all that information, they are telling us that this is the best practices.

And I think from a worker’s standpoint, we want our guarantees. And the only way we can see that something is guaranteed is if it's there. If we can look at it and see it there, and then we know it's there.

MR. PRINGLE: Thank you.

And for your testimony, Ms. Boyette, it seemed a fluctuation between state support, tuition, as well as third-party federal contributions, federal contracts, other contracts that you have.

Is it fair to say that that in those years, in which as you've suggested, when you have those contracts, paying for the obligations that are incurred at that time, be it in a prepayment-type context for medical benefits, would it be fair to say that if at one of your universities tomorrow you stopped getting any federal contracts or outside third-party support, that, in fact, by not prepaying in those rich years, the students would suffer and the educational component of your institution could suffer?

MS. BOYETTE: I think that's a big concern that I have had since I joined the University. I have been very concerned about -- because the trajectory has been upward. We have continued to receive more and more federal contracts and grants. We're one of, if not the largest recipient of federal grants, for research grant. But if that were to cut back, then where would we pay for that?

And, again, we have employees -- I know some employees who have spent their entire career, here at UCSD, now twenty-something years doing research, federal research. They've never done anything else.

MR. PRINGLE: I say this from an adjunct faculty position, because I teach at UCI, and I worry about enhancing the student contact as opposed to all of the research and other components. So thank you for focusing on that well.

CHAIR PARSKY: John?

MR. COGAN: Lakesha -- I have a question actually for the Chairman, I’m tempted to ask the Chairman how come the UC Regents have this policy of not allowing any employees on the Board, but I won't.

MS. BOYETTE: We're reviewing our policies.

CHAIR PARSKY: Who are those Regents?

MR. COGAN: So, actually, I have a question about retention.

Given these very sizable wage differences between UC workers and comparable workers at community colleges and so forth, do you see a big retention problem?

MS. HARRISON: Yes. Especially in the field that -- in the nursing and in those specialty fields that we have. The people who stay do stay for the benefits, but the people who now -- you know, in some cases we're seeing that it's a 50 and 60 percent turnover, because people get the name UC on their résumé because it is considered a prestigious place, but then they take that and they go work for time and half, double the money.

So now, especially in the radiology and nursing, people get two and three years under their belt and then they leave.

MR. COGAN: They get out?

MS. HARRISON: But people who have been here 10 or 15 years are here and they’re staying because they're vested and want this great pension, right?

MR. COGAN: Right.

What about the Cal State system?

MS. CHAPIN: It's pretty much the same. I think our salaries -- we have lags in some of our areas, and are at market in many others. But one of our main recruiting tools are the health benefits and the CalPERS retirement. And especially the retiree medical. CSU has -- we have a very, what I would consider, generous in comparison to some of the other groups that we've heard today. If you work five years, at age 50 you'll get lifetime retiree medical. And that's a real selling point for a lot of our faculty.

Because we're a defined -- we're in the defined benefit, we don't have the option of TIAA-CREF. I mean, we've got TSA's and 401(k)s and those types of things. But we're mandated into the defined benefit. And that has its selling points.

MR. COGAN: Judy, I have a different question for you, and it relates to the prefunding of health benefits.

As you've said, some large fraction of your funds come from outside of state appropriations and outside of tuition. And so if you moved from a pay-as-you-go system to a system that was funded in an amount equal to the annual required contribution, you would be increasing payments to your fund by about a billion or a little over a billion dollars a year.

What fraction of that would come from an assessment on federal grants, or grants from private organizations outside of California taxpayers and students?

MS. BOYETTE: Let’s see. Okay, 17 percent State General Funds and about 8 percent overall is student fees. So it's only about 25 percent. So it's two funding sources.

MR. COGAN: So 75 percent would come from outside?

MS. BOYETTE: Yes, yes.

MR. COGAN: Wow.

MS. BOYETTE: Yes. That's why I wanted to be here today, is to be sure that there was an understanding that this really is, I think, a different kind of situation than if you say the State obviously will still be here for a long time. We aren't really certain that all of these funding sources will be around.

MR. COGAN: Right.

MS. BOYETTE: And I will say, I've looked into this -- we've looked into this. Some of the larger research, academic institutions I know -- Columbia, Yale -- they have, years ago, begun prefunding their retiree medical, partly because of the federal contracts. Because if you could get it -- of course, they didn't have to get money from the Legislature or private institutions, but they now have about a third of their liability funded.

MR. COGAN: Right. So every dollar that you raise for prefunding from appropriated funds from California, there's going to be a payment from outside of California on the order of $5, or $4, depending upon how you count tuition; right?

MS. BOYETTE: Yes.

MR. COGAN: Wow, that's quite large leverage.

CHAIR PARSKY: Ron?

MR. COTTINGHAM: One of the things that you were talking about in your medical coverage or your health coverage for your retirees or for, I guess, it comes from your UC system.

MS. BOYETTE: Yes.

MR. COTTINGHAM: So my question was or concern is what happens -- I mean, your UC system has defined what happens when your retiree moves outside of that system?

MS. BOYETTE: Well, we are not providing direct care. So it's provided through contracts that the medical centers had to provide care through Blue Cross, through Health Net, through PacifiCare. So they just -- they are, though, in fact, in all of the areas where we have medical centers, our medical groups are the primary medical groups that our employees choose under those plans. But it is, in effect, our money. I mean, we're -- in a sense, we're cycling some of the payments back to ourselves.

MR. COTTINGHAM: Back to yourselves?

Okay, and towards the end of your presentation, I think you said what you wanted to do is maintain flexibility.

MS. BOYETTE: Yes.

MR. COTTINGHAM: And you have talked about your uniqueness.

And I think my perception is, that kind of dovetails into a lot of other things we've heard and I would equate to maintaining local control over what you're doing. Or you want to be able to control your own destiny.

MS. BOYETTE: I guess my concern -- I'll just be honest -- my concern was that in an exercise like you're going through here as a commission, looking at very difficult issues and for the State, the municipalities, these entities -- that if you were going to make recommendations, I was concerned that you not make recommendations that might be more restrictive in the sense of saying that it might be perfectly wonderful for the State to continue pay-as-you-go, for example, on retiree medical where I, anyway, do not believe it's a good answer for UC. And we need the flexibility to be able to answer our differing business needs. So whether it's locally or imposed from somewhere else, as long as they impose something that we can still operate within.

CHAIR PARSKY: Maybe to some extent what you're asking is that we take into account the uniqueness of UC in making the recommendations; is that what you're driving at?

MS. BOYETTE: Yes, yes. And that if it were a state -- something mandated by the State, that there was an ability to respond to differing needs within.

CHAIR PARSKY: One final comment I would make, and it kind of builds on what Curt had to say, this prefunding issue is a very important issue I think for this Commission to be considering.

I think it would be helpful to go to your union and see if your members would vote in favor of your position on prefunding. I'd be interested to know what their position would be.

I think your presentation was quite interesting. I won't challenge the rest of your presentation. That we can do in another context. But that comment I think is a very interesting one.

I'd like your union to -- we would request your union to give us their --

MS. HARRISON: Official position?

CHAIR PARSKY: Yes, their position on that.

MS. HARRISON: We can do that. But I can tell you as far as the members are concerned, one thing that UC is notorious for is “one or the other.” So if you're going to as, do we want prefunding in lieu of raises or in lieu something else? It's, like, “No.”

CHAIR PARSKY: No.

MS. HARRISON: I'll say this because this is the practice. This is not coming from nowhere. This is the practice. So if you go, then you can come back and say, "Your union said prefund, so therefore you didn't get a raise.” So if that's the word, okay.

MR. PRINGLE: That, too, should be part of that private conversation later.

CHAIR PARSKY: The private conversation you and I will have will be in the context of our next Regents meeting, not here.

Thank you all very much. I think that concludes our session for today. We really appreciate everyone's help.

(The meeting concluded at 4:06 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 8th day of August 2007.

DANIEL P. FELDHAUS
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