STATE OF CALIFORNIA

PUBLIC EMPLOYEE
POST-EMPLOYMENT BENEFITS COMMISSION

PUBLIC MEETING

Thursday, August 23, 2007
10:05 a.m.

California School Employees Association
2045 Lundy Avenue
San José, California

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

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A P P E A R A N C E S

PUBLIC EMPLOYEE POST-EMPLOYMENT BENEFITS COMMISSION

Commissioners Present

GERRY PARSKY, Commission Chair
Aurora Capital Group

MATTHEW BARGER
Hellman & Friedman LLC

PAUL CAPPITELLI
San Bernardino County Sheriff's Department

JOHN COGAN
Stanford University

RONALD COTTINGHAM
Peace Officers Research Association of California

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

JIM HARD
President
Service Employees International Union Local 1000

LEONARD LEE LIPPS
California Teachers' Association

DAVE LOW
California School Employees Association

ROBERT WALTON
Retired (CalPERS)

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A P P E A R A N C E S

PEBC Staff Present

ANNE SHEEHAN
Executive Director

JAN BOEL
Staff Director

TOM BRANAN
Policy Director

ADMAS KANYAGIA
Summer Intern

RICHARD KROLAK
Healthcare Consultant

MARGIE RAMIREZ WALKER
Office Manager

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Public Testimony

CAROL D. ADAMEK-FLATON
California School Employees Association (Retiree)

SARAH F. BAKER
California School Employees Association

PATRECIA C. BOLLIN
California School Employees Association

TIM CALLAHAN
Federated City Employees Retirement Board

LILA E. CANN
CSEA Retiree

DOUGLAS K. CORNELIUS
California School Employees Association

A P P E A R A N C E S

Public Testimony
continued

TED COSTA
The People's Advocate

EDWARD F. EVANS
NW Financial Group

WILLIAM FAWX
Ch 015 Cal State Retirees

BRIAN D. O'NEILL
SEIU, 521, Santa Clara County Chapter

CAROL C. RAMOS
California School Employees Association

HARVEY A. ROBINSON
RPEA

DAVID RODRIGUEZ
NIEF Local 101

MARILYNN M. SMITH
Service Employee International Union,
Local 521

ROWENA SMITH
California School Employees Association

LARRY YAMASAKI
SEIU, Local 521

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A P P E A R A N C E S

Presentations

SARA ROGERS
Consultant
Senator Sheila James Kuehl's Office

ROBERT A. BLUM
Hanson, Bridgett, Marcus, Vlahos & Rudy, LLP

GRANT BOYKEN
California Research Bureau

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Table of Contents

Table of Contents

Table of Contents

--o0o--

BE IT REMEMBERED that on Thursday, August 23, 2007, commencing at the hour of 10:05 a.m., at California School Employees Association, 2045 Lundy Avenue, San José, California, before me, DANIEL P. FELDHAUS, CSR 6949, RDR, CRR, in the state of California, the following proceedings were held:

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CHAIR PARSKY: I want to welcome everyone to our -- I think it's our sixth meeting of the Post-Employment Benefits Commission. I want to, on behalf of all of the commissioners and all the staff, I want to thank Dave Low, one of our diligent commissioners, for hosting us today.

We thank you very much for doing all this.

And before we get started, I just wanted to pay also special thanks to someone who is in our audience, and ask Rob, if you wanted to come forward and say a few things.

Rob Feckner is here, who is the president of the California School Employees Association and also the president or head of CalPERS.

Rob, thank you very much for being here and if you'd like to say a few words.

MR. FECKNER: Thank you, Mr. Chairman, and thank you, honored board.

It's a pleasure to host you. On behalf of the California school employees and our 210,000 members and staff, we welcome you. We hope you enjoy our facility. We're very proud of it, and we hope that you use it well. And you can come back and use it at any time. We appreciate having you here. And we wish you a good meeting today.

Thank you.

CHAIR PARSKY: Thank you very, very much.

Okay, I think that just a couple of comments that I would make as we get started, before we turn to our public comment period.

At all of the hearings that we have held throughout the state, I have tried to introduce them by first reviewing very briefly the purpose of the Commission, and then making it clear to the audience and to the public at large a basic tenet that has been put forward by the Governor and the legislative leaders.

The purpose of the Commission is to identify the amount of post-retirement pension and health-care liability that Californians will need to face and address, and then to evaluate approaches for addressing unfunded liabilities in connection with retirement benefits and health-care benefits, and propose one or more recommendations to policymakers as to how to address these liabilities in a prudently fiscal way.

The Governor and the legislative leaders have made it clear that promised pension and health-care benefits to existing employees and to retirees will be met.

On a number of occasions, as we have held our hearings throughout the state, people have come forward expressing concern that somehow promises that have been made were not going to be honored by the policymakers. This Commission has no authority to act. What we can do is to make recommendations. But the policymakers who do have authority to act, have made it clear that they will honor the promises that have been made.

The question is, how can we be prepared to finance these policies and deal with them in a way that doesn't harm the state from a financial and economic standpoint.

To some extent, today we're going to move into a new phase of our hearings. The purpose of these hearings was to bring forward experts, people who could provide on individual subject matters important input to the Commission and to the public at large.

Today, in the afternoon session, we're going to begin to discuss issues that, from the Commission's standpoint, may lead to policy recommendations. And each subsequent hearing that we have throughout the balance of the year, we'll spend a little bit more time in trying to see if we can't identify areas that the Commission wants to make recommendations to our policymakers about. And I think the public will have an opportunity to hear dialogue among commissioners, and then we'll try to put together by our deadline, which is January of '08, a full report with recommendations included.

So with that introduction, any other comments that anyone would like to make before we get started?

(No audible response)

CHAIR PARSKY: Okay, then we can now move into the public comment period. Since I'm the keeper of the script here, I hope I pronounce everyone's name properly. It's a challenge. I'll ask Dave Low, if I'm in trouble, to help me.

The first speaker is Ted Costa.

Ted?

MR. COSTA: Yes, I have two handouts here.

First, Mr. Chairman, thank you for allowing me the opportunity to come here. I believe I will speak for about five minutes, maybe six minutes, although I did just change the presentation a little bit.

I got my information from The Daily News and other newspapers. And nationally, I believe that the average pension is something like $19,000, and the PERS average pension is something like $19,300. So PERS is probably right on.

Overall, I believe PERS to be a good system, and I think PERS can be saved. I don't support the notion that it needs to be shut down and open up a new system. However, there are some things that can be done and should be done that will make PERS and STRS even better systems. And I am talking really about pension spiking and retroactive benefits, those two things. And it's very easy to do something about those.

So one of the handouts I'm giving you from People's Advocate Research, is "30 Ways to Spike your Pension."

So if you look at -- by and large, as I said the last time I spoke here that it was something like 250,000 teachers all seem to be playing by the rules; and in PERS, most all the people, all of the clerks, all the janitors, all the bus drivers, all the maintenance people are all playing by the rules. And if you go through the computer, you'll get something like 427 people in STRS who have pensions above 100,000. That's not very many as a percentage; and you have to consider a thousand school districts, a thousand superintendents, and probably two or three retired for each one, and some big school districts. So it's not too bad.

But when you get to Los Angeles and you get to the county employees there, there's 1,200 people making more than $100,000. And ten of them are between $210,000 and $316,000 pensions.

And I believe you had your actuary here last time told you that if you went from 2 percent at 60 to 3 percent at 60, it would only cost you 4 percent. And that's probably true, if someone played by the rules, like the vast majority of employees are doing, and each year you go 3½ percent up, as in the actuaries, and then you retire, you'd be fully funded. And most of those are fully funded.

But those who wait until the eighteenth or the nineteenth year and they pad their pensions in big ways -- and I will give you one example here, but there's 30 of them and we don't have time for all of them -- but the staff can tell you the tricks of the trade.

And incidentally, Mr. Chairman, I do believe that I have in my office a consultant who advertises on his Web site that he is partnered with PERS, that will teach state executives how to spike their pensions.

Now, if I was an employee at PERS, I'd be concerned enough about that to come to People’s Advocate, and I would give them all that information. It's a little more serious than Martha Stewart, I believe.

Where are we at here now?

One of those ways, I want to talk about just briefly is disability and how disability is used to spike a pension. As I told you, there's 30 different ways to do it. But on an average, when 79 percent of employees are retiring on disability -- which is really another word for tax-free pension -- you know something is wrong, and we'd better shut down the police department if it's that hazardous, or shut down the agencies that do this sort of thing.

It's just, first of all, they're cheating the system, they're not paying their taxes, they're not paying their fair share, and it puts a burden on the taxpayers. Because if in the last year you file workers' comp, then you are entitled to one full year of pay tax-free, and you get to add on your 3 percent on top of that, all spiking your pension. That's only one of 30 ways to spike your pension.

And I'll just -- because someone sent this to me, and I'll put maybe a little humor in the situation, but it's a very serious subject.

It's called, "Lesson on how to get the highest retirement." First of all, you become a sheriff with a college degree, and you work the night shift, seven days on, seven days off. You should work in traffic, on a motorcycle, on a weekend, on Catalina Island. Each of those, you get your pension spiked.

You want to be on-call on your days off. You want to handle explosives at sometime in your career. You want to take care of a dog or a horse.

And before the last year, you want to bank at least one year each of vacation, holiday, sick time, and take in-lieu cash payments for those hours in your last year. Don't file any expense reimbursement claims the last year, except allowances for incidentals, vehicles, uniforms, animals, or food expenses. You get more in your -- you get it every year in your pension if you don't do that.

You don't want to enroll in your employer's health plan, and you enroll in your spouse's health plan.

You get promoted within 13 months of your retirement.

And I would dare say that if you get an actuary and you just take those $100,000 pensions, and you look at the actuary on them, and you look at the actuaries on the rank and file, there's no problem. The PERS actuary told you at the last meeting that it wasn't a problem, and I believe that to be true. But you will find out, there's a rat hole there some place on this pension spiking. People are getting pensions and they're not funded.

If it be judged by the Legislature and the Governor that all these things should be allowed, they should be funded.

So if they're going to give this, there should be a subvention of funds at the time they are given, and then they find out maybe a couple of million dollars.

I believe the California Highway Patrol at the present time, so many people on disability, that when someone retires at age 50 with a potential 98 percent, because the Legislature gave them 4 percent and then two years later gave them another 4 percent on top of their 90 percent, that there's like $130,000 in their fund. It's gone within two years. And all of a sudden, the Highway Patrol pensions are the same as Social Security in the state of California.

You know, as a wise man once said: You can't be just against everything and you've got to be for something. I think there are two things that we could do that would take care of the problem.

First, I have another hat I wear, I'm on the Water Board. We hired EFI, which is PERS actuaries, to do an actuary for ours, because we went from 2 percent at 60 to 3 percent at 60. And six years later, after we did it, we found out that our pension obligation has gone to 42 percent of salary, when we told -- I was told 4 percent -- 4 percent is absolutely right if someone comes in today, works there 30 years and retires.

But when the general manager retires 30 days after he takes on 3 percent at 60 and the chief financial person does the same thing on a little district, it's big numbers.

So we have already at San Juan Water, we've already done a local ordinance to prevent pension spiking. The ordinance simply says: It's on your basic pay. And I would recommend -- I hope you would recommend -- that a model resolution be adopted and sent to the cities, the counties, the special districts of this state, so that they may enact this, and they could do a whole bunch at getting their actuaries in line.

Second is this: The retroactive benefits. I understand there's a lawsuit in Orange County. I'm ready to intervene in that lawsuit because I think that we need relief and the courts could give us relief. But if not, a simple initiative could probably stop the retroactive benefits.

Nothing to be said that a bonus can't be given to someone who has a pension that's maybe not adequate; but when someone's a 200,000-dollar-a-year executive and two months before they retire you've given this increase in pension, it puts an obligation on the system that is most unfair to all the rank and file people, to the 250,000 teachers and state employees who were playing by the rules.

And if we could do those two reforms, I think the system would, over time, adjust itself and go on to be a fine system.

Mr. Chairman, I thank you for the opportunity to present this to you.

CHAIR PARSKY: Thank you very much.

Okay, our next speaker is Lila Cann, and then we have Carol Ramos, and then Patrecia Bollin.

If I didn't pronounce your name correctly, I apologize.

MS. CANN: It was perfect.

CHAIR PARSKY: Thank you.

MS. CANN: Sorry, I'm a little short.

Good morning. My concern is the health care. And the reason is, I have a story to tell that I know happens to many, many people. The story I have to tell is, when my husband was not quite 54 years old, he had a massive stroke. He was in intensive care for over eight weeks, in the hospital for over three months. And we had coverage at that time from his employer.

After he was out of the hospital, we no longer had coverage unless we wanted to buy COBRA. The COBRA was $1,075.

My husband got disability after 24 months of $1,600 a month.

I had to retire to take care of him because I couldn't afford a full-time caregiver, and he was paralyzed so he had to have full-time care.

My PERS, because I had to retire early, was $489 a month. Out of that, because, thank goodness, I had signed him up with my health care in our school district, it only cost us $805 a month for insurance. So as you can see, most of our income went to take care of health-care benefits.

My family, my children, had to move in with us to help us from losing everything that we did have.

The point I have is that my husband worked for over 40 years paying into health care. When he needed it, we needed it, it wasn't there for us. So something needs to be done. We need a single-payer plan. We need health care for all.

Thank you.

CHAIR PARSKY: Thank you very much.

Carol Ramos. Patrecia Bollin will be next, and then Larry Yamasaki.

MS. RAMOS: I'm short also so I have to adjust this.

I'm here today to share also a story with you similar to Lila's. My husband had been working for a company for 35 years, and was injured -- tore the rotator cuff and a muscle in his arm. Was unable to continue doing the job that he was doing.

Within six months of the time, he was put on disability, his check became shorter, Workers' Comp committed an error, and was sending him -- paying him one-third of his salary.

My expenses went to the same as they were. My income went to less than half what was our monthly income. And I was the sole provider for my household, making only $1,200 at that time a month.

Luckily, my employer provided insurance that was able to pay for my husband's care. However, I retired three years ago at 62. I collect my PERS. Because I am now 65, my insurance benefits, starting the first of September, will be $863.43, which is more than half of what I receive from PERS.

At this point in time, I have read every piece of material that Medicare has sent me, and I have no choice but to stay with the plan that I'm at because I do have preexisting conditions and most insurances will not cover me. So I am totally disabled because of accidents that occurred through my work, but I continued working.

Unlike the gentleman has said, many people that are injured on the job do not stop working because their employers understand and allow us to work with the limitations that we have. Unfortunately, that isn't always the case. And I hope that whatever decision this committee makes, you consider that there are many, many employees just like me who give service to districts from anywhere from 20 years to 35 years and never ask anything other than what we feel we deserve.

But we see that in this state, the employees are the ones that are always injured as far as benefits. We retire at age 65. You'd better have some money put aside because you're going to have to pay the full amount of your insurance, because it's not like before where you were 65 and Medicare took care of you. As far as medical purposes, that no longer exists. They only pay a portion and we have to pay the rest.

Thank you for your time.

CHAIR PARSKY: Thank you.

Patrecia Bollin.

MS. BOLLIN: Yes.

Good morning. Thank you very much for listening to us.

I'm speaking also to preexisting conditions. When I was working for the school district, my husband retired earlier, while I was still working; and I put him on my plan as a dependent. I worked enough hours so that I qualified for medical benefits.

Soon after his retirement, he came up with cancer and so we were still covered. Then when I retired in Monterey County, which is where I reside -- most of the schools belong to a JPA -- we checked out all the existing plans that we could everywhere, and we decided to stay with the JPA as a supplement to our Medicare. And so, therefore, he was kept on it.

Thank heavens for that because four years after I retired, I had cancer. And we're both still on that JPA.

What worries us is the fact that if for some reason something happens to that, no other insurance company will take us, I'm sure, because of our preexisting condition.

So, therefore, I -- and, of course, with both of us, and any of you that are familiar with cancer or any other things, there's an ongoing that you're going back to the doctor. In fact, I had quite a scare this last January and, thank heavens, it was okay. But you worry and you worry and you worry whether another company would pick you up if it was necessary, would their premium be out of sight that you could not -- in fact, my Medicare medical premium right now, through the school district's JPA, is over $600 for the two of us. And we must pay that on a six-months basis. So believe me, you start saving. Because as I also sit down with employees and help them make out their papers with CalPERS as a retirement director, and I tell them, "You know what? You need to look and look and look. Because just one insurance will not do it nowadays."

So thanks. Please keep that in mind when you give your reports.

Thank you.

CHAIR PARSKY: Thank you very much.

Larry Yamasaki, then Marilynn Smith, and then Douglas Cornelius.

MR. YAMASAKI: My name is Larry Yamasaki. I worked for the Santa Clara County Department of Agriculture for 31 years as an agricultural inspector. I enforce the California Code of Regulations on issues of pesticide use and plant quarantine. Pesticide use included proper application and worker safety. Plant quarantine included insect and disease control.

I have a secure retirement and would like to see all Californians enjoy the same. I have health-care benefits for myself, but I'm concerned that health-care issues are currently impacting many other Californians.

I am active with SEIU 521 in lobbying for reform this year. Although all proposals are still on the table, AB 8 appears to be the most promising. In its amended form, it should address many of our concerns, including affordability through adequate employer, employee, and public participation. It should address cost containment through public oversight, such as an insurance commissioner.

Also, AB 8 should address usability through lower deductibles and eliminate preexisting conditions as a means to disqualify people.

Adequate drug coverage should also be addressed.

I urge you to support AB 8 in its amended form. It will help win the battle for better pensions and health care.

Thank you.

CHAIR PARSKY: Thank you very much.

Marilynn Smith.

MARILYNN SMITH: That's me.

Good morning. My name is Marilynn Smith. I worked for the State of California, for Santa Clara County, and for Valley Transportation Authority, for a total of 35 years. All public employment, all PERS. But some of that was part-time, when my children were small.

My husband does not have a good retirement, so I will support us both when he completely retires. I retired in 2005, and I'm now 61.

Few public employees embark on their careers with an idea of achieving great financial gain. That's actually not a joke. That's serious. But they do expect and deserve fair compensation within the constraints of public budgets.

One of the consolations offsetting less-than-stellar paychecks has been the anticipation of a secure retirement benefit at the end of our work rainbow.

For the past 15 years of my working life, I was a computer systems analyst. I could probably have made double my VTA salary -- double my VTA salary -- if I had chosen to leave and go to the private sector. But I chose a career in public service, and I stayed partially because of the retirement.

If I didn't have a decent retirement to look forward to, I would have had to make choices to leave VTA and earn more each year working for Cisco or Google or Yahoo!.

Workers and their unions should be the ones to negotiate wages and benefits with their employers in the public sector. That's the way it is in the private sector.

I'm a proud retired member of Service Employees International Union, Local 521. I'm thankful that I have a secure retirement. Every person who works their whole life should have the right to a secure retirement and health-care benefits. There should not be a lesser retirement for future public workers. Mr. Richman's mean-spirited initiative needs to be opposed and defeated.

Thanks for listening to me.

CHAIR PARSKY: Thank you.

Douglas Cornelius and then Brian O'Neill and then Edward Evans.

MR. CORNELIUS: Good morning, gentlemen, young lady. My name is Doug Cornelius. I was asked to talk about health care and how it affects people like me.

I've worked my whole life literally, almost. I started out as a fruit tramp. Before I was in school, I went to the public school system. Worked the whole time. Then I worked my way through college. I started my own business in landscaping. I later went to a trade school. Became a union carpenter and a mechanic. I'm now working for Clovis Unified School District as a maintenance mechanic/carpenter.

As I said, my whole life I've worked, and one of the main reasons we all work is not just to make money, but to take care of our family.

One of the reasons I chose Clovis Unified was because they had said if I was to work five years and attain the age of 55, my wife and I would have health care for the rest of our lives. So under that guise, we were willing to give up a percent and a half, and sometimes more, each year to go for health benefits.

If you figure that out, if you just work the minimum of 20 years, the last year you work, you've given up 30 percent of what would have been on your paycheck, plus 30 percent of what would be the basis for what your retirement would be, which could be used to offset what you get.

Well, that hasn't happened. That, as far as their promise. Now, we are making co-pays. And we just got a letter yesterday that the co-pays are going up, both for doctors and for medicines, and that when we retire, we will be making monthly payments also for what I assumed we already paid for. Kind of like "The check is in the mail."

Gentlemen, about three and a half years ago my wife came down with breast cancer. It got into the lymph nodes. And because it was delayed on the care, some of the lymph nodes broke and it spread throughout her body. So there was an aggressive regimen of treatment. A lot of the coverage was taken care of; a lot of it wasn't.

I want you guys to think about this: Your wife faces you under the circumstances I've just said and tells you she is sorry. She is sorry because she got sick. She knows that there is no way we could get supplemental insurance to take care of her when I retire, because guess what? Now, I can't retire and provide for her. And that's why we all work, isn't it? It's not recognition, it's not money. It's taking care of the family.

She also realizes -- in her mind, she thinks she is going to die, and there's only a million dollars' worth of coverage. Well, that sounds like a lot of money if you have none. But it isn't much money at all when you go to the hospital.

So I would urge you folks, if you see fit, to maybe address this issue. And I suggest Proposition SB 840 is a really good answer. And thank you very much for your time.

CHAIR PARSKY: Thank you very much.

Brian O'Neill.

MR. O'NEILL: Good morning, Mr. Chair and

Members of the Commission.

My name is Brian O'Neill. I am working at the assessor's office now. I haven't retired yet. And I have been working there for 11 years.

I am one of the chapter chairs for Santa Clara County SEIU Local 521, and I'm the chair of the Committee on Political Education for the entire 521 local.

SEIU in the County of Santa Clara County represents 10,000 workers. Under the leadership of 521, we have helped save jobs and public and mental health and in drug and alcohol departments during this past fiscal year. It was really tough for us this year.

I have been involved in several contract negotiations and pensions and retiree health care has always been an issue with both our members and the county.

In Santa Clara County, SEIU 521 and the County have worked together to have our medical retirement prefunded. For more than a decade, the County and our union have been as creative as we could be to make sure we invested some money into medical retirement fund.

Over the last few years, the County and SEIU have used every avenue to make sure that quality of services are maintained, by our union delaying part of a raise for six months and having modest gains in general wages. However, the County still needs to be competitive in order to attract the best employees.

SEIU 521 is planning for the fiscal '09 budget process. We're going to ask the Board of Supervisors to direct the County to invest our funds for medical retirement into PERS' other post-employment benefit bonds. We hope by getting a higher tax return on the savings account will enable the medical fund to grow faster and become fully funded sooner.

Our broken health-care system is the problem. We all know our health-care system is broken and it needs to be fixed by the state or the Feds. Universal health care is the answer in the long run, and we are hoping this year some reform will happen.

The committee should endorse a plan for universal health care to take care of all retirees.

My 85-year-old mother is a retired SEIU member from West Valley Community College. Last year, she had major back surgery. It was successful. I don't know how she could pay for all the medical costs if she didn't have medical retirement from West Valley.

The answer is not taking away medical retirement; the answer is fixing our broken health-care system.

Thank you.

CHAIR PARSKY: Thank you.

Rowena Smith, Edward Evans, and then Carol Adamek-Flaton. I hope I pronounced that right.

ROWENA SMITH: It takes me a little while, but I get here.

Thank you. I'm going to talk to you a little bit about the lack of health care.

I worked for a local school district for 32 years. Due to cuts, I needed to retire. I was not 65 so I could not get full Social Security. I was able to participate in the District's plan at the cost of over $300 a month.

As you are well aware, classified employees are not your highest paid, and so your retirement is not as high as others.

But, fortunately, my husband is still working. So I do have medical through him. As you can see, I do need it.

As with others, we both have preexisting health conditions, so no other insurance company is going to take us. And I find the future very frightening. There is no security, in that there will be health care for me for a long time.

Kaiser Senior Advantage keeps going up and covering less. Right now, if you're hospitalized with

Senior Advantage, you will pay $275 to $300 a day, plus your medications and other things. That's just for being in the hospital.

As you can see, it would not take long to wipe out a small savings account.

One of the other things that -- when I served on the State Board with the CSEA, I was out and about. And some school districts offered a cafeteria plan. And what they do is they say, "Here, you have X amount of money. Get what coverage you can." And the person there working would have to make a decision, "Who do I cover? Do I cover my children or do I cover myself because I am the head of household?" People should not have to make that decision. Please, let's fix our health insurance.

Thank you so much.

CHAIR PARSKY: Thank you.

Edward Evans.

MR. EVANS: Good morning. Thank you for the opportunity to speak to you.

My name is Edward Evans. I'm with a company called NW Financial Group. Our main office is in Jersey City, New Jersey, immediately across the Hudson River from where the World Trade Center used to be.

I'm here to spread the word -- and I'm speaking exclusively about funding of OPEB unfunded liabilities.

I realize that in many ways, people think that these liabilities are so large that it's going to be impossible to fund them in any way but by doing things like dropping benefits and other negative maneuvers. But I'm here, as I say, to spread the word. We have a funding structure. It is an arbitrage, to be quite specific, because it must be, where we will lend any amount of money -- literally billions of dollars are available for this -- we will lend the money to any G45 entity. The credit of that G45 entity is really not important because we then turn around and invest the money that was lent. And it's invested in government securities, U.S. Government securities or agencies exclusively. And all of this has a 13-year history, both in terms of the loan and the investment.

And when we look at the 13-year history, it actually not only can be paid and does it always cover the debt service on the loan, but in about 13 to 14 years, the unfunded liability is funded. And what remains in the bank are U.S. government securities.

Now I realize this might sound like it's pie in the sky, and you have no idea who I am. I can tell you that my company last year, we ended up, I think in terms of volume, number seven in the country in terms of financial advisory work. We also do, and have done work for years, a large amount of work with HUD.

But we're in Wall Street, we're the type of firm that really you don't see often, but we're there doing the work. And I just wanted to spread the word and let people know that the fact of funding is not unavailable, and it's not only available through crazy mechanisms, this is a conservative mechanism. And as I say, it's money that's loaned. Not off of the G.O. of the G45 of the entity. There is a requirement that there be a pledge to pay, but it's not a general obligation pledge. And it's held in government securities. And it works.

So I just wanted to spread that word, if anybody cares to talk about it. I'm here to speak to anybody. But it's something that is some good news, because this is a very daunting problem for everyone. And it's not something that is unsolvable, I guess that's what I'm here to say.

Thank you.

CHAIR PARSKY: Thank you very much.

MR. EVANS: And I really appreciate the opportunity to speak.

CHAIR PARSKY: Thank you.

Carol Adamek-Flaton. Is that right?

MS. ADAMEK-FLATON: You're closer than most.

It's “Adam-ak Flay-tin.”

I am a retiree of CSEA, and I worked 38 years in Alum Rock School District, a district that does not provide retiree benefits.

I now buy my insurance out of my ex-employee's plan, and I pay $435.74 a month. In addition, $93.50 is deducted from my Social Security for Medicare-D. This is $529.24 that reduces my retirement income.

When working, I paid less in the premiums, but COLAs on our salary never kept pace with the insurance premium increases.

A lot of people that I know, most of whom are in school districts, are only working for the insurance. They're part-time employees. Their salary doesn't cover much more than that.

We had one lady who, one month, because of an error in payroll, ended up paying the District $1.98. That's crazy.

Affordable insurance and retirement security, if ever there was an oxymoron, that's it. 12 percent annual insurance increases do not equate when PERS gives 2 percent annually. If the workforce needs to have more security than that, then I would recommend that you go for something like SB 840.

Thank you for your time.

CHAIR PARSKY: Thank you very much.

Sarah Baker, Harvey Robinson, and then Bill Fawx -- F-A-W-X.

Sarah?

MS. BAKER: Thank you, Mr. Chairman, and honorable board members. My name is Sarah Baker. I'm a CSEA member, and I am still working.

I am a student advisor at Santa Rosa City Schools, up in the wine country, and I'm also a Marine Corps veteran and a fourth-year law student. So you can tell I'm not staying in the public field for much longer.

I'm here to advocate for my future and the future of Californians. In my future, I do not see myself retiring. I will not be able to afford the luxury.

My district pays a cap at the time of retirement on medical insurance if that employee has worked at least four hours per day and at least 15 years. The retiree is responsible for any increase in insurance premiums above that cap.

Last year, two health insurance companies pulled their retirees out of their general pool. So instead of spreading the risk across the board, they decided to concentrate the risk in a single pool, and the increases were between 30 to 40 percent for the retirees.

The retirement incomes, of course, are fixed and does not compensate for these increases in health insurance premiums.

Many retirees may be retired from their primary jobs, but many are forced to seek supplemental income so they can afford to be retired.

My husband is unemployed at this point in time, and I had to add him to my health insurance. Unfortunately, I owe my district over $600 because I added him to my health premiums.

If there was single-payer health care, which is SB 840, I would not have had to worry about my husband losing his job, and I would not at this point owe my district $600.

A young friend of mine that I know, who is a college student, was looking for major medical insurance. And because she takes antidepressants, she now pays $280 a month for her health insurance for major medical. That's all it covers. She's being penalized $200 a month because she takes antidepressants.

So I'm asking you, please to look at SB 840. We need universal health care in this state.

Thank you.

CHAIR PARSKY: Thank you.

Harvey Robinson.

MR. ROBINSON: Good morning. My name is Harvey Robinson, and I retired with 29 years of service with CalPERS, 22 years of which was with Benefit Service and seven years with the Office of Long-Term Care. And I'm currently director of health benefits for the Retired Public Employees Association.

RPEA, as an advocate organization with some 33,000 members, represents some 445,000 CalPERS annuitants, encompassing some associated 226,000 health-covered lives.

The RPEA board of directors has unanimously endorsed SB 840 Kuehl, in principal and as amended July 10th, 2007; and by implication, its funding source, SB 1014, as amended April 23rd, 2007.

This endorsement of the single-payer system reflects not only support for a new structure that would enhance negotiations with health providers and integrated health-care systems, but would also provide more affordable health care for public agency and classified school annuitants and their employers.

By removing health insurers from the temple, the OPEB liability would be substantially reduced for the State of California, for cities and counties, for school employers, and for other public employers.

Another method for reducing OPEB liability for public employees hired July 1st, 2009, and later, has recently been proposed.

The Moorlach-Richman initiative, possibly conjured up from the Lord Voldemort School of Retirement Wizardry, in reducing retirement allowances by 30 percent to 60 percent from the current retirement benefit, would dramatically impact recruitment, retention, and create a hostile work environment.

In declaring war on the honorable career of public service, not only would retirement and health benefits for part-time employees be eliminated, but entitlement to health benefits would be severely diminished for those remaining eligible.

I would encourage you in writing your final report not to include this morally unconscionable initiative as a reasonable alternative to reducing OPEB liability. Thank you.

CHAIR PARSKY: Thank you.

Three more speakers.

Bill Fawx and then Tim Calhoun, I think, and then David Rodriguez.

MR. FAWX: Good morning, you all.

My name is Bill Fawx. Not "wolf" but “fox,” spelled F-A-W-X.

CHAIR PARSKY: I apologize for not seeing the

"X."

MR. FAWX: It's a little unusual name, yes, it is.

I'm here to speak on behalf of myself. I'm a Chapter 15 Cal State Retirees. We're in the Sierra Foothills just north of Sacramento.

And by way of background, I'm a survivor. World War II, Korea, 26 years with the Naval reserve and the State of California for 37 years.

Of those 37 years, DMV 12, State Board of Medical Examiners for 12½ and the State Board of Accountancy for 12½.

During that period of time, I have found it useful -- useful -- to reflect upon the past in order to assess the present to see where we might go in the future.

And I address this question to you all: If you had available to you a copy of a prior report on the study of the State of California's employment practices going back to a prior governor -- that governor was Ronald Reagan. He appointed a task force of business and professional people. I'm sure Bob Walton will remember that. There was a report out of that thing. Part of that report was a recommendation for PEMHCA legislation. And I'm aware of that report because I was drafted -- at that time I worked for the medical board -- I was drafted to work for the medical board member of that task force, Forest J. Grunigen, M.D.

It was an interesting assignment. But I would urge you all to try to dig up and get a copy of that report to see where we are at the present with respect to that report, where you might want to go in the future.

I think it would be a useful thing.

Where to go to get it? The State Library might have it. The Legislative Analyst's Office might have it. Either house of the Legislature might have it. Some place that study still exists in writing.

And last, a little note of humor. You're going to get an awful lot of references to statistics, statistical reports, and data. There is a book out that I've used down through the years that says, "Don't be blinded by statistics, and how to lie with statistics."

I'll leave you now and thank you very much.

CHAIR PARSKY: Thank you very much.

Tim Callahan -- or Calhoun? Callahan?

MR. CALLAHAN: It's “Callahan.”

CHAIR PARSKY: Callahan?

MR. CALLAHAN: Hi, I'm Tim Callahan. I'm with the Federated City Employees Retirement Systems, City of San José. I'm a trustee and also an employee of the City of San José for approximately 17 years. By no means do I speak on behalf of our retirement board. My thoughts are my own.

We do need a single-payer medical plan. We are living longer. And I don't think people are getting sicker, but the cost is going up. And I think the insurance companies have proven that they know how to break the system by taking too much money out. It needs to be taken out of their hands.

Recently, in the City of San José, two of our smaller unions had to undergo contract negotiations. And part of the wedge the City attempted to use against them was the GASB 45 reporting and OPEB. They were told that vesting needed to go from 15 to 25 years for medical. They were told they would have to make enormous co-pays. They were told that they needed a two-tiered program.

None of this is true, although we have a local publication, I think it's called the Mercury News, who seems to rail against public employees for whatever reasons. And the comments in that newspaper generally refer to city employees as "union pukes," and on and on.

I actually somewhat resent that.

I worked 19 years in the private sector and paid Social Security for 78 quarters. Because of GOP and WEP, my Social Security benefits are substantially cut because I now am a public employee. So I know both worlds.

I took the job with the City of San José knowing that I would get these benefits. But now, apparently they're saying: It ain't so anymore, we can change that. But I certainly have legal opinions here that say they can't.

The unfunded liability is what it is. And I guess it's right that it should be reported because some of it is public money, although our pension funds actually provide 70 to 80 percent of the pensions being paid out. And with the retirement medical trust also administered by a retirement board, more than likely, we could cover that unfunded liability.

Now, I have unfunded liabilities myself. My electric bill 30 years out is probably a lot more than I have in my pocket right now. So is the food that I'm going to eat and certainly my mortgage.

The medical retirement shouldn't be such an enormous burden that it's going to break the bank. And I don't believe it is. You can use statistics, as the last speaker stated, to make your case any way you want.

But if, in fact, we can't cover our retired public employees -- and I would assume in the private sector, they can't cover them, either -- you know, I don't know if we're supposed to walk out on the ice after we retire or what. But I've worked 17 years with the City of San José to secure this benefit, after I did not secure the benefit in the private sector. I suppose I've made sacrifices. But, actually, employment with the City of San José has been rather good. I certainly can't say anything against that. It's a very good place to work.

Although as a fiduciary on our retirement board, I think if they tried to cut the benefits or put vesting to 25 years, all those that can retire will go now, and that will be a run on the bank, and that will be an enormous hit to our retirement fund because we'll have more people now receiving benefits than are paying in, and nobody will be attracted to taking a job with the City of San José if they can't get the benefits that the previous employees have gotten.

This problem needs to be addressed, it needs to be fixed. It's gone on for too long. Too many people have gone into bankruptcy after retirement because they can't pay their medical expenses.

I mean, maybe we should retire people and give them a weapon or some medication to end it all if they see that they can't pay their medical.

Another deal that they tried to put on some of our union co-workers in the city was that you only get the single medical benefit, nothing for your spouse or any dependents. This isn't right. People shouldn't be using GASB 45 as a tool against union employees. We need to set the pace as public employees, and hope that the private sector will fund what they need to do also.

Anyway, single-payer health is the way we need to go.

Thank you for your time.

CHAIR PARSKY: Thank you.

The last speaker is David Rodriguez.

MR. RODRIGUEZ: Honorable Chair and Commission Members, I came here this morning at the invite of my co-workers there. I'm a City of San José employee. I've been there approximately 21 years. I started work back when I was about 11 years old and started paying into the Social Security system. Little did I understand, you know, what the future would hold, in that I express the same sentiments as my co-worker, Tim Callahan. I don't look forward to too much receiving from Social Security because of the WEP and the GOP to offset pension there.

So I looked later on in life, I was working in the real estate industry and was attracted to the City of San José because of the promise for better benefits and health care and retirement.

Now that I'm hearing that they want to take that away because of this GASB 45/43 requirements that they now have to meet, and that scares them, so they send that message down the road to the rank and file, saying that, "We're going to take away your benefits" or "we're going to have to look into that."

And I have before me an article that talks about that. And it seems to appear to me in this article that it addresses it as a last resort. Not the first forefront. You know, you don't go in there and start bombing away and then try to find survivors. You know, you go in there first and start talking reasonably and logically.

I don't think that that's a good way to approach it. I don't see this other initiative by -- I think it's Mr. Richman there, our senator or assemblyman, I'm not sure which, that has proposed this, that's coming down the road for 2009. I think that, you know, whatever it is that you do or whatever recommendations you've made and the things you've heard here today -- and it's scary, because I now qualify for retirement, I can walk away from my job. And hearing that I have to go and look for work elsewhere in order to supplement income and that I am faced with the same situations. I have a condition that is a preexisting condition. I won't mention what that is. But I'm faced with that, having to go out into the future in retirement and possibly have to get coverage for that. I'm concerned about I still have a young child at home, and I have a wife that I have to take care of.

So, I mean, it's kind of scary to look out at this and see some of the things that these folks are faced with. And I think it's highly incumbent upon you that you find a solution.

I don't think that the employers -- the municipalities, the water districts, the public agencies -- should be coming back to us for a promise that they made to us, to say, "We now have to have you reduce your benefits or totally eliminate them to make up our obligation."

If the federal government has placed this obligation upon the municipalities, then they should come up with a way to figure out how to pay for it.

They promised us a retirement and health care, so give it to us. Don't take it away from us. Find another way, because I know there's a lot of money that's being wasted in programs and funding. You hear about it all the time in the newspaper.

And I think the newspapers should get it right and stop attacking good working, hard-working, dedicated, loyal public servants who give their life and time 20, 30 years at a time to service. I think they've got it wrong.

And just because the private industry is undergoing some turmoil in the financial areas where they get laid off and suddenly they're not going to get their cake and ice-cream, that they should now look at public service employees and say, you know, "You've got to lose yours, too.” I don't think that's correct.

We all make choices and decisions early in life. I made it 20 years ago to leave private industry and to go into public service. And I thought I made a good decision. Now, I'm questioning that from the things that the way people are deciding the things should be or should become.

And I think, again, it's highly incumbent upon you, and hopefully you make the right choices, and that you take everything that has been said today and go in the right direction.

And I thank you for your time.

CHAIR PARSKY: Thank you all very much on behalf of all the Commission.

I want to thank the public not only for being here, but for the comments that have been made at each of our meetings.

Just a few additional administrative comments before we move into our first discussion panel.

Everyone is aware that our next meeting of the Commission will be on September 21. It will be in Los Angeles at UCLA, one of the great UC schools.

And the only other thing I would say administratively is we're still working on trying to deal with one administrative problem that we have with respect to one meeting in November, because one of our commission members can't quite attend for a very good reason. We'll leave that as a mystery until he decides that he wants to announce.

But today, a number of our commissioners have felt that we needed to have a presentation about current health-care proposals that are being considered. And there are a few members of the panel that we had thought would be here that can't because of pressing needs. But I think we're going to be able to cover it with the help of the panelists that are here.

And I just want to say that as we move into this subject, that it is truly an important subject. But I think it's important that we bear in mind that this subject and anything that may be done in terms of broad health-care proposals shouldn't so influence us that we don't come forward with meaningful recommendations or suggestions on how to deal with the subject of the unfunded liabilities relating to health care, should these proposals not be enacted. This is something we don't have control of.

We do have a responsibility, it seems to me, to come forward with proposals to assure people who have been made promises, that they will be honored.

Anne, do you have any other comments that you would like to make?

Oh, I'm sorry --

MR. PRINGLE: Mr. Chairman, if I could, for my personal benefit, for members of the Commission and others, I certainly welcome hearing what's happening in the Legislature now. But I don't quite understand how it necessarily applies to what we are doing at this single moment in time. I mean, the Legislature, if they wish to address this issue, the bills pending, many of the speakers specifically pointed to them, that the Legislature will recess on September 15th or prior. And, therefore, we have a couple meetings after that to see if we wish to engage in that discussion.

We don't know what any of these bills may look like if they are passed and signed into law until later on in our deliberations.

So it's nice to know at this snapshot in time what might be talked about, but I actually -- and I welcome enhancing my personal knowledge. But it doesn't make much sense to me in terms of our full deliberation as a body that's looking at how to make recommendations to the Legislature at the end of this year, to hear what's going on right now when, in fact, in the next month it will be resolved in Sacramento to the point of the Legislature activity for the year. And if they don't resolve it, then we will certainly be able to apply ideas in our report, if we wish for them to address it.

So I just do think that –- you know, I'm willing to listen. I just don't quite understand what value it adds seeing this snapshot before any legislative activity takes place.

CHAIR PARSKY: Well, we try, in the operations of this commission to be responsive to all commissioners. And since several have requested a discussion about it, I would just urge all of us to be a little bit patient.

I think you have a good point in terms of the timing of decision. But I think it will -- any deliberations we want to have later in the year will be advanced by making sure we understand what's on the table. And so that was the underlying purpose. But I think certainly your point is well taken. But as I said, I really don't think anyone intends to have prospective or possible proposals legislatively in any way that would prevent us, undermine us, do anything that would cause us not to make meaningful proposals with respect to how to deal with the liabilities that are accruing and that exist in order to make sure we honor the promises. But I appreciate your comments at all times.

Yes?

MR. HARD: Yes, I agree with some of Mr. Pringle's concerns because there are three specific proposals. And I thought that, personally, that the issue -- since we are going to issue recommendations -- and it would appear from statistics that I've seen that the inflation rate in health care and the lack of actual quality, compared to, frankly, other industrialized countries, that no matter what we come up with -- prefunding, other proposals -- perhaps that they will be inadequate for any institution.

Apparently, they are inadequate for large profit-making corporations. Certainly they will be an extreme challenge to any government entity, no matter what its commitment in terms of keeping commitments to its employees.

So without addressing this crisis, which seems obvious to most people, I think we're going to have a very difficult time coming up with proposals that will meet this challenge.

We might be able to come up with some proposals that, in fact, do address that. I didn't see the charge of this commission being limited to technical solutions. But I do agree that those proposals will be disposed of before the end of September, one way or another.

And so my interest was having the broader issue and the implications of this, what I would consider a crisis on the charge that we have.

So thanks.

CHAIR PARSKY: Other comments?

Dave?

MR. LOW: I would also state that even after the legislative session ends, I don't believe that this issue of health care is going to be completely disposed of and not on the table. And I don't think that you can talk about a GASB unfunded liability without talking about the state of health care, the entire issue of access to health care, the cost of health care. And I think that we have to take that into consideration, irrespective of an outcome in the legislative session because it's a reality. So I believe this discussion is timely, whether it occurs now or after the legislative session. I think it's important that we hear this morning of the health-care debate as part of the whole discussion.

CHAIR PARSKY: Okay. Anne, do you have any other comments, administrative, for us?

MS. SHEEHAN: No.

CHAIR PARSKY: Okay, Richard, would you --

Oh, I've just been reminded, if anyone has their cell phones on, if you could turn them off, it would be helpful.

As I said, there are two panelists who were going to be here, but because of pressing issues, as pointed out by one of our commissioners, in Sacramento, they're not here. But I think we will be able to have a presentation/discussion of, quote, the "trends," at least, that are before us.

So, Richard or Sara -- Sara, you go first?

MS. ROGERS: Well, thank you very much for giving me this opportunity to make this presentation to you.

I wanted to ask how much time we have now that there are two panelists that are not here.

CHAIR PARSKY: The same amount of time you would have had with them.

MS. ROGERS: Remind me how much time that was.

CHAIR PARSKY: Why don't you go ahead with about ten minutes or so, and then we'll hear from Richard and then have some discussion.

MS. ROGERS: Thank you.

Well, as you know, SB 840, which has been introduced in the California Legislature --

THE AUDIENCE: We can't hear. We can’t hear.

CHAIR PARSKY: Maybe a little closer to you.

THE AUDIENCE: Your mike's not on.

CHAIR PARSKY: Now, it is.

MS. ROGERS: Now, can you hear?

CHAIR PARSKY: A little closer.

MS. ROGERS: I'll just do this.

Senate Bill 840 is California's plan to establish, at long last, a truly universal health-care system in California. I think all of you are aware of that. And I think that the single-payer really does offer a great deal to this discussion. I don't envy your job at all. I think it is an incredibly daunting task that you're looking at. But a universal single-payer health-care system really has many practical applications and can explain sort of the reasons why we have been so unable to solve the health-care crisis over the last decade.

We have a situation where health-care costs are growing four times faster than wages. And in that scenario, it's really unimaginable how you could possibly solve any kind of prefunding obligation or GASB 45 obligation without addressing the underlying systematic cost-containment problem that is pervasive throughout the health-care system.

And with SB 840 and with a single-payer model, what you actually have is the only proven and tested model that actually can contain cost in the long term, as well as provide up-front savings in the short-term. And it is not something that is simply theoretic, it is not something that is anecdotal, it is something that is very proven. It's been scientifically proven.

We have a study that shows that under a single-payer model, employers would actually be entirely relieved of their retiree health contributions. In fact, prefunding would no longer be required under a single-payer model. Under SB 840, in fact, employers are only asked to contribute a percentage of payroll on their active employees, and would no longer be required to pay anything for their retiree health-care obligations. And so this would essentially relieve all employers, including private-sector employers and public-sector employers, for their retiree health obligations.

And the reason that we can afford to do it is because it does contain cost. If you look at every other industrial country in the world, as well as right here in the United States, you see that the single-payer models have, in fact, contained cost. And so whatever you may believe about quality or access -- and I can address those as well -- the simple fact is, it contains cost. And that is something that I think every one of you ought to consider.

And the reason that I think it's important for you to consider SB 840 is that as you look at these problems, you have a role to play in the way that the Legislature actually does address them. And so that is why I am here, in the hopes that this Commission actually does play a role and offers an opinion to the Legislature as we embark upon health-care reform this year, as well as next year. As Mr. Low pointed out, there is, without exception, nothing that could possibly be passed this year that doesn't take away the need to establish a single-payer system.

And I'm going to just talk briefly in the more broad sense about why single payer and why it contains cost, and the system that we have today is one that segregates every one of us into different risk pools. We put people into public programs if they're low-income. If they're disabled, if they're seniors, they go into the public risk pool. And those populations are uniquely and specifically more likely to be sicker, have higher-acuity illnesses, and more expensive to cover than the rest of the population. And so then when we wonder why our public sector systems are underfunded, it's really no surprise. We've literally taken the highest-risk population and put them into public pools.

And then, among the private sector, still we split every one of us into different risk pools according to our employment status, according to where employers obtain coverage. And then each one of those risk pools then competes with one another in a marketplace. Not on the basis of health-care quality, but on the basis of managing their risk.

And, of course, if I'm running an insurance company, there is no reason for me in my business model to seek to encourage high-acuity patients who can't afford high premiums to be part of my risk pool. It doesn't make sense.

And what we've actually envisioned in SB 840 is a true public-private partnership, where we are simply the single-risk pool. Instead of splitting every one of us into different risk pools and then spending 30 percent of every health-care dollar just to figure out -- and hire actuaries, figure out who's sick and how sick they're likely to ever be and then assign a premium to go along with it, a complete waste of money. Instead, put people into one risk pool and let them choose their own doctor, let them choose their own hospital, and let competition among providers actually prevail, and let that bring the highest-quality competitive system within our health-care system that can improve quality. It can also contain cost.

And so with that basic model, you actually achieve the best of both worlds. You achieve a system that you can contain cost because we're the single purchaser and, at the same time, you have a system with a truly competitive marketplace of health-care providers. And that's the kind of choice we believe people really want.

A recent field poll just came out yesterday that showed a huge and sudden shift in the public's perception of single-payer, and it is now turned around, it has completely shifted in terms of where the people are. More Californians now actually support single-payer than reforming the insurance-based system. So the public opinions are quickly changing on this point. And I think businesses will also find that they save money. Employers outright save money. The premiums paid under this system are less than the premiums they pay currently. And all of their employees are covered through retirement.

So with that, I think I will leave it to questions.

I'm getting a little look that maybe it's time. So thank you very much.

CHAIR PARSKY: I don't think there was any look at all.

Richard -- and then we'll come back to questions.

MR. KROLAK: Thank you.

There we go.

I am, as you indicated, pinch-hitting a little bit this morning. So I'm going to be trying to very quickly go over the basic ideas behind the Governor's proposal and Assembly Bill 8, which now stands as the legislative leadership's proposal on health-care reform.

Very quickly, I think that, given some of the comments from the commissioners earlier and some of the people you heard commenting from the public, I think that the basic themes here are that there are questions about who is to be covered, what is to be covered, what benefits, and ultimately how do you pay for it. And, obviously, in terms of dealing with OPEB obligations, to the extent that you have valuations that make certain assumptions about baseline benefit designs and long-term medical trends, those elements clearly have a big impact on those valuation numbers.

So to the extent that any proposal, whether it be SB 840 or AB 8 or the Governor's proposal, to the extent that they address those issues and change the nature of the long-term medical trend in particular, then you're going to see an impact on those valuations and the corresponding impacts on the OPEB valuations going forward.

So with that -- again, bear with me. Again, I'm going to try to hit the highlights, first of all, in the Governor's proposal, which basically is referred to as the “Shared Responsibility Model.” Some of the architects behind that proposal participated in the development of the package that is actually being implemented as we speak in the state of Massachusetts. It does revolve around the notion of both an employer contribution as well as an individual mandate. So you have a situation where employers will be asked to provide a basic contribution, but at the same time, something a little different, there will be something that's called an "individual mandate." So that if you're an individual who does not receive care through your employer or provide it in some other means, you will be required to purchase a baseline level of coverage.

So clearly, that's a little bit different.

One of the other elements around the Governor's proposal that is a little bit different is that there is a recognition of one of the concerns, it's called the "cost shift." And in California, particularly that revolves around the reimbursement rates for Medi-Cal and the other public programs that were just mentioned. California is known for providing broad benefits but with low reimbursements. So that creates a situation where private insurers are oftentimes, they feel they're put in a situation where they have to make up the difference, and providers basically shift cost to those of us who have insurance.

The Governor's office estimates -- and you can see in their presentation -- it's something on the order of 17 percent of the premium is a result of this cost shift. So one of the other elements that's included in the Governor's proposal is basically what they refer to as fees to be levied against physicians and hospitals. And in return, there would be increased reimbursements for the Medi-Cal and other public programs.

So, again, some elements that are a little bit different from perhaps some of the other proposals that have been discussed previously in California.

Clearly, the Governor's proposal tries to lay out baseline benefit designs, an emphasis on wellness and preventive care. There are discussions around diabetes prevention and treatment, obesity prevention, tobacco cessation, so on; all of which would presumably be taken into consideration in terms of, again, requirements for benefit designs. And one would presume or the assumption is that there would be corresponding reductions in long-term costs.

So you have a situation where basically, again, under the Shared Responsibility Model, the idea is that the Government has a responsibility to provide a healthy, productive, economically competitive state. Doctors and hospitals are in a situation where they will have an expanded population with insurance. The number of uninsured, the uncompensated care goes down. The presumption is that there will be fairer compensation for those providers; but then in return, again, there are some revenue situations that impact providers as well.

For health plans, again, they get an expanded market. The presumption, again, fair compensation; but at the same time, there are some requirements on them as well. Some of the issues around guaranteed issues, guaranteed renewal, that would change the underwriting requirements and, again, would try to address some of these questions that were raised earlier around the question of preexisting condition that makes it extremely difficult for someone to particularly go into the individual insurance market.

And there's also a requirement that insurers would spend at least up to 85 percent of their revenues on actual care. So that's actually something that is in the HMO world to some extent in California now, but that would become a formal requirement.

And then for employers and individuals, then they would have access, presumably, to a more affordable and more stably priced coverage and consequently they would have a healthy, productive workforce.

So the Governor's proposal does try to take into account a number of elements. Some are relatively old, some of them are new. But the idea, again, of shared responsibility and the idea that all the participants in the process -- employers, individuals, insurers, providers -- would all participate in reforming and remodeling the system.

There are some interesting elements here in terms of funding that become a little bit problematic in the sense of, again, the discussion around raising additional revenues. And part of the assumption of the Governor's proposal, as well as AB 8, for that matter, is there will be increased matching funds from the federal government.

To the extent that you increase reimbursements under Medi-Cal and Healthy Families and the other public programs where there is federal financial participation, the assumption is that the federal government will participate in that process and that will be part of the new revenue stream.

One of the interesting elements that -- again, this is very much a moving target as some of you clearly recognize. One of the programs that has been talked about again, both by the Governor and by AB 8, has to do with what's called CHIP, the State Children's Health Insurance Program. Both proposals basically talk in terms of expanding eligibility and bringing more people into those programs. And the assumption is that there would be, again, the additional federal financial participation to help pay for it.

To give you an idea of how all the parts have to fit together, as I'm sure most of you know, the CHIP expansion has been a major issue of debate at the federal level. There are separate House and Senate bills that are awaiting some sort of conference action, literally, as we speak, to try to expand those programs.

Interestingly enough, the national administration, the Bush Administration on Friday came out with additional information to states, outlining what they see as their bottom line, meaning the

Administration's bottom line, in terms of what would be the state requirements for expanding the eligible populations under the CHIP Program.

Generally speaking, the analysis that I have seen very quickly over the last few days is that virtually no state will be able to meet those requirements. And so the question of that additional funding is immediately thrown into the mix.

So, again, lots of moving parts here. And, again, under the Governor's proposal, certain assumptions about how all the various players will participate -- again, shared responsibility, a key element in terms of adding in the individual mandate.

There are a couple other elements that again are similar to AB 8 and so you'll again bear with me if you see some commonalities or some themes across both proposals. Both proposals would expand statewide purchasing pools. The idea would be that those who, through no other means, could provide access to insurance, would be able to participate in an expanded purchasing pool.

The specifics of the purchasing pool are really not very clear at this point. They would be largely left to the Managed Risk Medical Insurance Board to define the specifics. But the idea would be that there would be this -- again, as referenced earlier -- the ultimate solution would be the public purchasing pool that would provide coverage.

There is also, under the Governor's proposal, a proposal for what I'm going to call tax conformity, in the sense that the California tax code would be changed to conform with the federal laws around health savings accounts. So that would be a change for California.

There's also the requirement that all employers would provide a section 125 plan. Very simply, the idea is that that way, employees can set aside money for their share of cost in a tax-advantaged situation.

So, again, the emphasis tends to be one on reducing the so-called hidden tax to address the question of the lower reimbursements in public programs, to provide coverage to all through a variety of both employer and employee mandates and the individual mandates, and try to, again, have shared responsibility by all the participants in the system.

So, again, I hope that I've done the Governor's proposal reasonable justice.

And if you like, since there are so many themes that are common to AB 8, I think I'll just move into that.

One of the major differences with AB 8 -- and, again, it is literally, as we speak, there was about 150 pages of amendments that came out on Monday so everyone's digesting what all that means -- one of the fundamental changes with AB 8 is that it does rely more extensively on an employer mandate. Whereas the Governor's proposal relies on a shared responsibility between employers, employees, and individuals, AB 8 relies predominantly on employer mandate and an expansion of public programs, existing public programs, and, again, expansion of a public purchasing-pool arrangement.

So there are some similarities.

Again, both the Governor's proposal and AB 8 do rely, to some extent, on what are referred to as “pay-or-play” formulas. The Governor, 4 percent on payroll, AB 8, 7½ percent on Social Security wages. The idea being that an employer either provides coverage that meets the baseline requirements or they pay into a separate pool.

Instead of an individual mandate, in AB 8 it basically says that employees of firms that pay into the pool -- again, they pay rather than play – they would receive care through an expanded purchasing-pool arrangement. And part of that arrangement would be a sliding scale. So depending on their income, family income as a percentage of federal poverty level, they would have some obligation, some responsibilities in terms of a co-insurance or a co-payment on the premium.

Basically, AB 8 would look to, again, expand eligibility in Medi-Cal, Healthy Families. Again, as I just mentioned a few minutes ago, there is obviously some very lively discussion at the national level about allowing states to do that, and how that would actually work. But in any case, one of the assumptions about AB 8, like the Governor's proposal, is the ability to make those kinds of adjustments and expand those programs.

There would be, under AB 8, again, a new expanded -- it's called the “California Cooperative Health Insurance Purchasing Program.” Again, it would be the expansion of a new publicly supported purchasing pool. Again, it would have a sliding scale requirement, depending on family income for individual contribution.

Like the Governor's proposal, AB 8 does require employers to establish section 125 plans, so that, again, employees could take advantage of a pretax situation for their share.

Under insurance market changes, again, similar in some ways to the Governor's proposal, guaranteeing issue does require community rating of all plans by 2010. It does some things in terms of trying to expand the existing high-risk pool. Again, what is now called the Managed Risk Medical Insurance Program, not so many years ago, was called the Medical Risk Program and it was originally started as a high-risk pool. That was the first program managed by what is now the MRMIB board. So the idea is you would expand that.

And there has been prior legislation that would basically assess an additional fee on existing premiums to expand the enrollment in the high-risk pool. And so that has now become part of AB 8.

It would also expand what are currently underwriting requirements for the two to fifty. The small group market would be expanded up to 250. That, again, revolves around guaranteed issue, put some limitations around underwriting requirements that insurers are able to apply. It basically has floors and caps in terms of annual increases, so that all of those things would now be applied to a broader range of the insurance market. And then it also has the 85 percent of premium requirement on health plans.

Both the Governor's proposal and AB 8 try to address the question of cost containment by, again, emphasizing wellness, preventive care, so-called healthy lifestyles. Both proposals try to talk in terms of expanding what are referred to as pay-for performance criteria. Very simply, the idea is that if medical groups perform in certain ways in terms of meeting certain benchmarks, in terms of how their treatment modalities roll out, they are, in effect, compensated at higher levels. So if someone has a heart attack and their physician immediately starts them on, say, aspirin therapy and beta blockers, then that counts as a good thing and helps them in terms of their pay-for performance criteria.

So both the Governor's proposal and AB 8 look to expand those kinds of, in a sense, evidence-based medicine criteria that would actually -- the feeling is, hopefully begin to impact not just the insurance marketplace, but also the delivery of health care.

So, again, both the Governor's proposal and AB 8 have some commonalities. Actually, the major themes there in terms of what role for the employers, what roles for individuals, expansion of existing public programs, what would be, again, the federal financial participation in the expansion of those programs, those are all major themes here in California. Those are all themes we see being played out in a number of other states across the country.

So in some ways, the debates that are occurring here in California are not all that unique. The number is a little bigger here in California, but a lot of the issues are essentially the same.

So if I can, just very quickly, let me mention a few of the -- some of the other sort of national and state trends that seem to be coming into focus. Again, the idea of how to expand access to insurance, how to expand access to care. And those two may not be the same.

One of the things we're finding is that a number of people who have insurance still find themselves in the emergency room. So there is a question of access to insurance, there is also a question of access to care.

What is the role of the employer? What about the so-called shared-responsibility model? What is the role of the individual?

The question of, again, maximizing federal finance participation, virtually all states look at Medicaid and the CHIP programs. And, obviously, as I indicated, the national administration of the Congress is weighing in on those issues literally right now.

Most states, like California, are looking to expand or establish high-risk pools. And also one of the things that was talked about by some of the public speakers this morning about dependent coverage -- covering spouses, covering children -- so that is also another theme that we're seeing in a number of areas throughout the country.

Again, AB 8 and the Governor's proposal, to a large extent, maintain the existing linkage to the labor market. They look to expand public programs and expand public purchasing pools. Again, themes we see in other states.

The Governor's proposal and AB 8 both would try to modify the insurance marketplace through underwriting reform, guaranteed issue, requirements on health plans in terms of how much of their premium dollars to be spent on patient care and so on. And, obviously, SB 840 stands in a slightly different picture in all of these issues and addresses some of these same concerns about who is covered, what is covered, how it's paid for, obviously in a very different way.

There are some unique issues in California that I just want to mention real quick. Because the Governor's proposal and AB 8 both rely on a particular role for employers, there will be some discussion about ERISA. It's federal legislation. Generally speaking, the legal analysis around ERISA is -- I'm not an attorney, so I'm not going to delve into it. I'll simply say that for most analysts, they agree that either of those proposals is likely going to have to withstand a judicial challenge. The pay-or-play proposals, generally speaking, raise questions around ERISA and the federal mandate in terms of states trying to regulate employer benefit packages. So there will probably be an ERISA issue.

We have another unique characteristic here in California in terms of how we deal with tax increases. So both the Governor's proposal and AB 8 talk about fees. “Is a fee a tax?” remains to be seen. That's another issue that will likely have to stand some judicial testing.

If it's, in fact, a tax, not a fee, then you raise the question of two-thirds vote requirement. And, again, the funding mechanism for SB 840 also that's an issue that will need to be addressed.

Again, in California, we have a relatively high number of uninsured so it makes our problem a little more difficult to deal with.

Current public program reimbursements, as I mentioned, generally are a little bit low compared to other states. To give you an example, generally speaking, in Massachusetts, which has a shared-responsibility model that they are trying to implement as we speak, generally speaking, their uncompensated care reimbursements were somewhere in the area of about $1,300 per individual. California, the estimate is around $300 to $400. So you're starting from a much lower base in terms of public contributions.

The California labor market is somewhat unique in the sense that a very high percentage of our employed people are employed by small employers. All the numbers suggest that it is small employers who are least likely to provide a comprehensive employer-based health insurance.

So, again, another part of the California puzzle that makes the solution a little bit more difficult.

And, obviously, the initiative process in California -- again, anything that happens in the Legislature has already been mentioned by some of you, that even if the Legislature and the Governor would agree on something in the next three to four weeks, that probably won't be the end gate. There will likely be judicial challenges. There may be even an initiative process. I'm sure many of you recognize that a couple of years ago there was a pay-or-play proposal, SB 2, that was passed. It was challenged through the initiative process and overturned.

So we have some unique factors in California that will make this process even more interesting, I guess, for lack of a better term, and may take a little bit longer to arrive at a solution.

California is not unique or not alone in addressing this issue. Again, I mentioned that a number of other states are trying to deal with this. And there are also some proposals at the national level that are being discussed.

Very quickly -- and, again, these are painting things with a very broad brush here, just to give you a theme. There are sort of basic three reform approaches that are being discussed within Congress. One, I'm going to call fundamental reform in the nation's health insurance system, expansion of existing public insurance programs, and strengthening the employer-based health insurance system, the current system.

Under the fundamental reform, you're seeing proposals to significantly alter the tax environment for both employer and employees. So the idea would be to level the playing field and to make all insurance premiums basically tax deductible. The argument is that that would fundamentally alter the relationship and begin to address the questions of access and cost.

There is at least one major proposal on the Senate side that would, in effect, eliminate the existing employer-based system with a two-year phase in and move everyone into what, in essence, would look very much like the current system for federal employees. Basically, regional purchasing arrangements. There would be a two-year phase-in, where employers that currently provide coverage would, in effect, cash out the premium. That would become salary. And then individuals would be in a position to purchase care through competing health plans within regional health-insurance exchanges. Again, it would look very similar to what federal employees currently have access to.

There are discussions in Congress about federal-state partnerships. Basically, adjustments to the matching relationships and trying to have more extensive waiver programs and some things like that, that would allow states more revenue from the federal government to be more creative in terms of providing access to care.

And then, last, there's actually a proposal in the House that would basically remove or eliminate much of the existing employer system and, in effect, expand Medicare so that virtually everyone would receive care through the Medicare program. So that would become the version of a universal single-payer system.

There are some, again, proposals to expand existing public programs, things like allow Medicare buy-in at an earlier age. One of the concerns that, again, you've already heard from a number of speakers, both today and in previous meetings, is the sort of pre-65 group, the early retirees. So there are proposals at the federal level to allow a buy-in to Medicare generally around 55. Some have discussed it going down to 50.

The idea of eliminating the two-year waiting period for eligibility for Medicare if you're disabled. Again, you heard one speaker this morning raise that issue.

So there are proposals in Congress to modify those eligibility criteria and allow people to get into the Medicare system sooner.

We've already mentioned the expansion of Medicaid and CHIP. Again, obviously a very hot issue right now, one that will be played out over the next few weeks and months, probably years.

And also the idea that expand Medicaid eligibility and CHIP eligibility to include single adults and parents. One of the things that some states were able to do under the existing CHIP Program was if the children were eligible for CHIP, they were able to get a waiver from the federal government and cover the parents of the children. So if the children were in CHIP, they could cover the parents as well.

Typically, those waiver programs are designed like the Medicaid waivers, but they have to be done under cost neutrality. And so it is now becoming somewhat problematic for states to come back and basically want to expand that and say, "Well, we need additional funding." And again that gets us back to the debate that's going on in Congress today.

And then lastly, there are some proposals that would try to strengthen the current employer-based system. There are some proposals for employer mandates. There are other proposals that would try to address questions of affordability for small employers. In particular, there have been a number of proposals that would try to expand association health plans so that particularly small employers would participate through larger purchasing arrangements through associations that would go across states.

So there are a number of proposals in Congress. Again, it remains to be seen just where they will land.

Because we're in a presidential election year, I wanted to take just a quick minute to comment that virtually all candidates clearly recognize that health-care reform is a major issue. The reference is made to the field poll here in California that you're seeing the same themes across the country.

Many of the proposals that currently you're seeing from the candidates -- and, again, as you move through the campaigns, I suspect the candidates will be in a position of having to flesh those proposals out, and you'll see more and more detail -- right now, you're seeing the differences that are occurring between the major candidates reflect the long-term differences between the political parties. So, generally speaking, you see Republican candidates tend to focus on tax incentives and private insurance, and the Democratic candidates tend to strengthen the employer-based system with an expanded role for public programs. And again, there are some nuances there across the candidates. But as a general rule, that's what we're seeing from the candidates in the two major parties.

So what does all this mean? The reality is, again, as you've already heard, there are factors that are affecting the health-care cost. And while we do see some evidence that insurance premiums seem to be moderating, sometimes that's referred to as the "underwriting cycle," oftentimes this is a result more of plan design changes, shifts in cost sharing, and reduction in pharmaceutical costs because of greater reliance on generics. So many employers, for example, in their benefit designs are changing their co-pays, they're incentivizing their members to use generics. And so we are seeing some moderation because of those activities.

But it seems to also be the case that the major factors affecting health-care trends, demographics, utilization, technology, and provider consolidation are, in fact, continuing. If anything, they may, in fact, be accelerating.

So the reality of the demographics is that we do have an aging population, we do have lifestyle issues. Again, you've heard enough about the number of -- the increase in the number of diabetics, the questions of obesity, coronary artery disease, and so on and so on and so on, that most of medical science would agree to a certain extent that they are lifestyle-based.

There is the reality of cost-shifting from public programs. The extent that there is that cost-shifting goes on, it's certainly subject to debate. But I think most would agree that there is some cost-shift clearly here in California because of low reimbursements, that clearly is an issue.

We are seeing greater utilization. There are new treatments. There is more intensive diagnostics. We do see consumer demand going up for a variety of reasons. Again, much has been made, for example, of pharmaceutical directives, consumer advertising. There is, again, more intensive diagnostics. There was actually, in my local newspaper, there was an article last Saturday that, by a local physician, who talked about a young woman who brought her son in from soccer and hurt his ankle, and he went through the evidence-based analysis, concluded that he had a sprained ankle, and the mother insisted having an X-ray or an MRI. And the doctor –- and he had to engage in this conversation that basically said, “Based on the evaluation, the evidence-based criteria, I don't need to do that.”

But consumers do expect and we think we're paying for it, so we think we should get it.

Clearly, technology is having an impact. We are seeing new prescription drugs, some of which are very expensive. We are seeing new imaging technologies. We all want access to them.

We all talk about health IT. And certainly, there will be some beneficial aspects to health IT in terms of less errors, the clarity of diagnostics, the idea of being able to have clear personal medical records and so on, those are all pluses, those are all positives.

But those health IT systems won't fall out of the sky; they will cost money. So there will be some ramp-up costs that we will all have to figure out how to cover.

And finally, there is the reality provider consolidation and enhanced market position for providers. We went through a period of time in the early nineties, the sort of heydays of the managed-care world where the health plans, the health insurers had the heavy hand. They were able to negotiate very, very good rates. You did see some dramatic, even year-to-year declines in premiums. That's changed.

We now see providers and health insurers on a more equal footing. In some marketplaces, providers have the upper hand, they are able to demand higher reimbursements. Those reimbursements get passed on, and that is a reality that we're seeing in the marketplace.

So there are some things that simply are there. Any health-care reform proposal is going to have to try to address those. And, obviously, the proposals that are being discussed here in California, other states, and nationally, in various ways, in their own ways, try to address each and every one of those concerns.

Finally, the question of preventive care. Evidence-based medicine, you see that theme continually, regardless of the proposals.

Whether or not that will really reduce the long-term health-care trend is -- frankly, it's a mixed bag at this point. We don't know. The track record we have right now is open, the evidence is mixed. Even the other countries that are oftentimes referred to that have universal systems, in some ways, they are all, in their own ways, again, having to address a lot of the same issues that we're seeing here in the United States.

The demographics, the technology, and so on, are beginning to affect those systems as well. They're all trying to figure out how they're going to continue those systems.

Much was made, for example, of the French system. Just within the last few weeks, the new French administration tried to raise the issue of how much -- because a major funding source for that system is, in fact, a payroll tax. I believe it's around 18 percent. The administration there is recognizing that is beginning to have a substantial dislocation impact on that labor market. And there are a couple of economists who are much better about talking about those things than I am. But clearly, that administration is saying, "We can't continue that. We have to find another way to fund this system. We have to broaden the base or figure out how it is we're going to continue to provide the care."

So even those systems are having to address some of these same issues today.

And ultimately, you're down to a question of what's covered and what's not covered? The question is, again, who says no and how does the "no" get said?

The last line I included in your presentation is from Jonathan Gruber. And you can all read it, so I won't bother. And the reason I mentioned or wanted to use this quote is, actually, Dr. Gruber is an economist at MIT. He was a major architect of the Massachusetts plan. He is a participant in the actual implementation of that plan. And he had a role in the Governor's proposal here. And, in fact, many of the financial analyses of the proposals here in California were completed by Dr. Gruber.

So I thought it was informative that I would include this quote from him as kind of the final comment here so that, again, you're still back to who is covered, what is covered, and how you're going to pay for it. And that ultimately those are the real questions.

CHAIR PARSKY: Thank you very much.

Sara, if you would like to make any additional comments given the fact that was a little longer than ten minutes, we'll certainly --

MR. KROLAK: I was wearing three hats, so…

CHAIR PARSKY: No, I'm joking.

Do you have any comments?

MS. ROGERS: I'd honestly like to respond to the questions from the Commission.

CHAIR PARSKY: Okay. Yes? Let's start.

Teresa?

DR. GHILARDUCCI: In order to maybe bring up the differences between AB 840 and the Governor's --

MS. ROGERS: SB --

THE AUDIENCE: Microphone.

DR. GHILARDUCCI: -- SB 840. Just to elaborate on those differences again, I can't imagine how the ERISA challenge is going to be overcome, frankly. The federal law says, "Look, you can't tell an employer in California to do something differently," and expect that employer to be able to compete in Illinois. You know, so that's the reason for that ERISA problem.

Does SB 840 eliminate that issue? And what is the revenue base for SB 840? Because it's quite clear that both the Governor and the AB 8 -- the revenue base is, again, the employer, which means, of course, employees -- below the Social Security maximum, which is, it's paid for entirely by employees and their employers for wages under, what is it, $96,000.

MR. KROLAK: $96,000, yes.

DR. GHILARDUCCI: So can you tell me differently about the revenue base and the ERISA issue?

MS. ROGERS: Regarding ERISA, we think we actually are not subject when we run into ERISA, because we are trying to skirt that line between fee versus tax. We are tax. We're a two-thirds vote in order to fund the bill or the initiative.

So with that, we would tax the population, and the employers as well, to provide those benefits. And so, therefore, we don't run into ERISA, in our view.

And in terms of -- and you're asking for specific percentages. And the base would be above $7,000, so there's a $7,000 floor for both the employer and the employee, and up to $200,000 of income for the basic premium structure, which is a combined 11.95 percent, with the employer, under the bill as currently drafted, contributing 8.14 percent and the individuals contributing 3.87 percent. And then as currently drafted, there's a 1 percent surcharge above $200,000 of income for the individuals.

So that would offer employers a very significant, sizable savings, because any employer that is currently offering any type of benefit is spending significantly more than that for their health benefits.

DR. GHILARDUCCI: So are the employers in favor of SB 840?

MS. ROGERS: Well, some of them are. And many public employers are, many counties and local government officials, school districts. LAUSD, for example, recently passed a resolution of support based on estimated savings of about $300 million in the first year alone. And then a large number of small businesses have become supporters of the bill from both parties. And then we are also having conversations with large employers. And we hear behind the scenes that there is an openness to this that there hadn't been in the past. No one so far has come out and actually supported it, I think more for kind of cultural reasons than anything else. So we're working on that, and do expect to see more employers come out in support.

MR. COTTINGHAM: Hi. Thank you.

My question basically goes to the pooling, and it would be for each of you. Because under SB 840, you talked about having one pool, there would be one pool for Californians in its entirety. And under either the Governor's plan or AB 8, because it's kind of mixed back and forth, you talk about expanding a high-risk pool.

Now, it seems that pooling is part of the cost factor of insurance. So it seems like one major pool that everybody is in would kind of level out the cost, or just expanding high risk would tend to have increased costs.

I guess I would ask both of you to address your high-risk pool and then how the universal pool would react.

MR. KROLAK: I think the existing arrangements, again, as have already been indicated, both the Governor's proposal and AB 8, in a sense, try to build upon existing arrangements. So those broad categories of risk-pooling that do currently exist would be continued. So you would have, again, the expansion of an individual marketplace. Because of underwriting reforms, the assumption is that that risk would become more manageable and therefore more affordable.

The employer-based system would, again, because of some of the other changes that are discussed, would become more stable, more manageable.

The public purchasing arrangements, the current sort of Healthy Families pool, for lack of a better term, again, the idea, I think, that both AB 8 and the Governor's proposal is that they would become more stable, therefore, more affordable. And then, obviously -- ultimately, the high-risk pool where everyone else is left, the idea that that would become a situation where because, again, of some of the underwriting reforms and doing away with preexisting condition, you would have a more stable arrangement.

But clearly, there would have to be cross-subsidization. It would be a situation where you have a de facto, if I can use that term, broader pool because you're going to continue to have the cross-subsidization across each those of pools.

To the extent that you're continually relying on an employer-based system and you ask employers to basically provide the baseline of funding, you're always going to have some degree of that.

And so I think your point is well taken, that, you know, there are some things to try to stabilize those pools and to address the questions of access and cost over time. But ultimately, the baseline that you have today will basically still be in place.

MS. ROGERS: And I think that is exactly the -- that's one of the primary points of 840, is that not only do you have the up-front, kind of simple administrative costs that go into figuring out who is sick and how likely they are to get sick, but you also have a situation where the competitive and creative forces in a system with many risk pools are one that drive risk pools to figure out ways to shed risk rather than simply provide up-front, long-term care.

If I'm moving from plan to plan year after year as I have in CalPERS, been in three different plans, there's little financial incentive for one single risk pool to invest in preventive health care, or and also invest in some of the other technological advances, like infrastructure, like electronic infrastructure, for example. The funders of our health-care system are different risk pools, insurance companies, and it's fragmented. And when we look at our needs for cost containment, such as electronic infrastructure, investment in preventive primary health care, investment in our health education workforce, you see that the fragmentation of all of that funding is not structured in a way that you can actually implement those changes. And that's something that many health economists speak to a lot, is that the fragmented funding situations we're in prevent us from investing in things we know save money, like electronic medical records.

And so fundamentally we think that the system that splits us up is just simply never going to give us the health-care system that we all deserve. And it's not a radical thing to put everybody into one pool.

MR. KROLAK: If I can just make one other comment. It's actually one of the elements of the debate that's going on now about the expansion of the state children's health program in effect gets to this question, because one of the concerns is that, to the extent you expand the eligibility of that program, then you get what's called "crowd out," and that some number of those children would otherwise be covered by private insurance. And I think even the congressional budget office came out with an estimate, something like 40 percent of the new enrollees in an expanded CHIP would, in fact, have been individuals that were covered by private insurance. And so you do have that arrangement that you're going to have to address.

CHAIR PARSKY: Dave?

MR. LOW: Two issues, Mr. Krolak, the same for Ms. Rogers.

The first one is how, under AB 8 and the Governor's plan, are retirees covered for health care, and what would the impact of those initiatives be on GASB?

MR. KROLAK: Fundamentally, they don't call out retirees as a specific category. They basically maintain, in a sense, the existing employer-based system. So there are assumptions that, again, because of these kinds of reforms, you're able to stabilize those environments, reduce the long-term trends, therefore, you're not providing disincentives for employers to continue that kind of coverage.

But neither of those proposals, at least as they're currently construed, specifically address retiree coverage. They simply try to stabilize, make the current system more affordable, and then in that sense, again, provide hopefully a system that doesn't continue the disincentives to provide retiree coverage.

MR. LOW: So that, in essence, unless there is some significant cost savings, there would be no impact on GASB?

MR. KROLAK: Right. Yes, I would argue that, again, and go back to my original comments, that one of the key elements about a GASB, you know, OPEB valuation is the long-term trend: What's the long-term medical trend? And to the extent that these proposals address that, then you will see some impact.

MR. LOW: And the second question is, how do those two proposals address or how would they impact the current PEMHCA pool, which is, I guess, the second biggest purchasing pool in the nation?

MR. KROLAK: Again, the assumption -- they don't address PEMHCA specifically so that the existing arrangement would continue.

The assumption, again, it was by -- the spillover effect, in terms of stabilizing the insurance marketplace, reducing costs overall, there would be clearly a benefit, presumably, for PEMHCA. Because, obviously, PEMHCA participates in that marketplace.

Certainly, the health plans that participate in PEMHCA, even the self-insured elements of it, to the extent that there is a commonality of evidence-based medicine, the IT investments and so on, they would all benefit from those initiatives.

MR. LOW: The same questions for you, Sara.

MS. ROGERS: Well, under SB 840, as I already mentioned, retirees would be part of this system. And essentially every California resident would have access to this plan regardless of where they were employed and when.

And I think what you see in the current system, is that individual employers are liable and on the hook for the failure of the larger system to contain cost. And what this bill does is it pools that risk, and it relieves the State of California, as well as other employers, from the risk and puts it into -- it kind of pools that risk.

And so in addition to kind of expand slightly further, is the existing arrangements could also purchase benefits above and beyond anything that was offered under this plan. So the benefits under this plan are extremely comprehensive. However, the existing systems could potentially still engage in the marketplace to purchase additional benefits above and beyond what they were already eligible for.

Does that answer your question? Or is there further?

CHAIR PARSKY: Any others?

(No audible response)

CHAIR PARSKY: Let's try to bring this back a little bit to the efforts of this commission.

Comments from either of you in terms of -- going back to what Curt said as we entered -- given the time frame for this Commission, given the time frame for these proposals, and maybe your anticipation of what may happen, what role can the Commission play in this process from your perspective?

MR. KROLAK: I think my general comment would be that the role for the Commission would be, again, to highlight the importance of medical care at cost care trend. I mean, clearly that is going to be a major element in terms of any employer's OPEB liability going forward.

I wouldn't endorse at this point any one proposal because, obviously, there are, again, lots of moving parts.

CHAIR PARSKY: I don't think you have any concern about that.

MR. KROLAK: Good. But conceptually, I think the idea that you recognize that there are lots of moving parts, that there are lots of issues, particularly here in California, but ultimately to the extent that since you're able to get a modification of the long-term health-care trend, then you are going to see some modifications in the ongoing OPEB liabilities for all employers.

CHAIR PARSKY: Sara?

MS. ROGERS: Well, I think that, first of all, you have a very significant role to play in that you are a commission that is uniquely tasked with understanding how we are going to pay for the liabilities that we in the state of California have taken on. And I think that it's clear that those liabilities can really only be met in the context of fundamental health reform of the overall health-care system.

And with regard to SB 840, certainly we are continuing to allow the proposal that evolve and ensure that it does meet the needs of the retirees that you are responsible for. So we are, A, extremely happy and asking for any assistance, any input that you might have with regard to our proposal to improve upon it and ensure that it does achieve the goals; and then I think, at the same time, it is our hope that this Commission convey to the public and to the Legislature the need for the comprehensive reform to address these issues.

And we do think that SB 840 is, in fact, the only proposal that has any hope of actually, truly achieving the goals of your Commission.

And I know that you mentioned you probably aren't going to take a position on particular legislation. But I think, hopefully policy goals and broader discussions around the direction that the state is heading in, I think the Legislature is extremely interested to hear your perspective on the broader health-care policy.

CHAIR PARSKY: Thank you very much.

Okay, with that, I think we'll take our lunch break, 30 minutes. And then I think we can move along with the afternoon agenda rapidly.

(Midday recess taken from 12:14 p.m. to 1:07 p.m.)

CHAIR PARSKY: The first subject for the afternoon is a subject that some people may fear will not be exciting enough. It has to do with federal tax issues and the implications for Californians.

Now, Robert has decided that he is going to make this so interesting that no one dozes during this session.

Is that right, Robert?

MR. BLUM: Absolutely. Absolutely. Taxes after lunch is very exciting.

CHAIR PARSKY: No, this is obviously an important subject and one in which we're going to need to step back as we develop our recommendations and see how tax recommendations at both the state and the federal level fit in to the overall recommendations coming from the Commission. So with that, we'll try to move this along.

Leave enough room for high-level questions, Robert, but proceed ahead, Bob.

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

DR. GHILARDUCCI: Your microphone button needs to be turned on.

MR. BLUM: Well, we just tried it. Is it working now?

THE AUDIENCE: Yes.

MR. BLUM: Start again.

Thank you very much for inviting me.

This is taxes after lunch. This is very exciting. We'll keep you all awake.

My name is Bob Blum. I'm a lawyer with Hanson Bridgett in San Francisco. I'm a tax lawyer. I do benefits work. I've done it for longer than I care to admit. I work in the public sector and the private sector. I actually was one of those people who wrote ERISA when it was before the Congress, so I do a lot of Washington work, as well as work with private clients.

And I want to talk with you about federal taxes, and kind of why in the world would a California commission want to bother with federal taxes? I think there are a number of answers.

The first is you cannot avoid the Feds. You just can't.

The first question to the last speakers was what about ERISA, an ERISA preemption? The federal government is there, the federal regulation is there. It's going to affect all benefits, pensions and retiree health care.

The second reason is, I think that you can actually have an impact. You have a mission of developing good policy. The Feds listen to that, and they particularly will listen, I believe, to a commission that does not have an axe to grind. You're not a taxpayer. You're not a lawyer that's coming in and saying, "Please do this for my client." You'd be going to them and recommending good policy, which would be good policy for them, as well as for retirement systems and members of the retirement systems.

A number of the suggestions I have would be of extreme importance and cut the costs, not only for members, but for retirement systems. If you can do that, if you can be a catalyst to get the Feds to change what they're doing, that would be of extraordinary value.

Now, the third reason is, I have had substantial success in getting the federal government to pay attention to issues of this type. So I think that it's absolutely doable. There's no guarantee, but why not try?

We have had, in the last 2½ years, very substantial success on major policy, federal tax policy issues that were driven by California needs, that California systems led with. And we got excellent legislation. Now, if we can get legislation, we also can get Treasury and Revenue Service regulations.

So those are reasons why I think it's useful for you to take this on and to listen to this and to think about it.

And what I want to talk with you about is both pension and health-care issues. This is a long presentation, I'm not going to go through the whole thing. I'd like to talk to you about two key issues first. I'd appreciate questions during the time. No reason for you to sit back and wait. And then if there's some more time, we can talk about additional issues.

So you also need to know a little bit about the history of California pension systems. And if you're looking at this handout, it starts on page 4, it's called "The Legacy Systems." California has the largest pension systems in the country, public and private. It has the most successful pension systems in the country. They are the public systems. They were established, for the most part, in the 1930's or even before that. And when they were established, taxes were irrelevant. Nobody thought that the tax code -- and there was one at that time, and it dealt with pensions -- nobody thought the tax code had anything to do with the California retirement systems. Taxes were irrelevant because states were immune, and still are, from taxation. I think that's how they started out.

But that's not what happened. And in the early 1970's, the St. Joseph, Missouri, Police and Fire System was audited by the Internal Revenue Service; and the Internal Revenue Service said it is not tax-exempt, which created a firestorm in the public sector retirement community.

And so in 1977, the Revenue Service said, "Okay, we're going to go study this and we're going to see when the rules, the tax rules, really should apply. So we will not audit, we will not treat as taxable the trust funds that hold public-sector retirement system money."

And from that point on, most public-sector retirement systems -- certainly the ones in California, certainly the ones that were established under PERS and STRS and the '37 Act -- ignored the federal tax system, which was not a great idea. Because in the early eighties, they discovered that, in fact, the tax system did have -- the federal tax rules had an adverse impact on the members of the retirement system. Under section 415 of the Revenue Code, which if you really want to know about it, I'll tell you about it, a lot of people have heard that number, which is why I use it. And in 1988, CalPERS led to get special legislation. It led the nation to get special legislation to create a special rule for public-sector retirement systems.

And at that point, the public-sector systems started to wake up and started to think, "Gee, maybe we really have to pay attention to the federal tax system."

Now, there has been other special legislation; but what has happened since that time is, we have had an extremely uneasy relationship between the Revenue Service, the Treasury, and the largest and most successful retirement systems in the country that cover hundreds of thousands of people and provide retirement benefits for hundreds of thousands of people for decades. An extremely uneasy relationship.

The Revenue Service does not understand the public-sector system. They know it's out there, they know it holds enormous amounts of money, but they don't know how it works.

So I've had conversations with senior Treasury lawyers, saying, "Do you know this is what we do in California?"

And he says, "Pardon me? No, I've never heard of anything like that before."

And then he has said something else, which is important for you to know. He said, "Will you please write me a letter and tell me about that?"

Now, I'm engaged by a client. I go back to the client and say, "Would you like me to write this letter? I think it would be of value."

And they say, "No."

And I say, "Why?" And the answer is because they want to keep their head down, because the public-sector systems are very wary of the Revenue

Service throughout the retirement community. And, frankly, there's good reasons for that.

But the point for the Commission is that you can take issues to the Revenue Service, you can take issues to the federal government in ways that are policy-based and do not raise issues for particular retirement systems.

Now, why are retirement systems concerned? Because the Revenue Service doesn't understand them. Their policies and their procedures and their programs are all private-sector-based, the legacy systems have been around for a very long time. And the Revenue Service announced rule is there is no statute of limitations with respect to qualification of pension plans.

So if I were to follow the private-sector methodology, and I were to go to the Revenue Service and say, "Will you please issue me a letter that says that my client is okay?" -- and I'll explain what that is in a minute -- it goes to a GS-13 or a GS-14, who has never seen anything like this before. And if one of those people starts to go through the private-sector methodology, it may work and it may not work.

I'll give you one very little, simple example. What you do when you talk with the Revenue Service is, you negotiate, you know, "Is this okay? Is that okay? Do you want some language changed?”

Usually what happens is the Revenue's reviewer asks for some change in the plan document, governing plan document. That's our statute. That's the '37 Act or the PERS law or the STRS law.

And then the rule is, you've got 90 days to get that changed. If you don't get it changed in 90 days, you're out the window. The likelihood that you could get the legislation that you need in 90 days through our Legislature without change is probably not very high. The process doesn't work well for the public systems. The process can change, and that's really a key part of what I want to talk with you about because the policy is, it should change from my perspective.

So I've been talking about something called "IRS letters of approval." And what's this about? Way more than 90 percent of the private-sector retirement systems go to the Revenue Service and say, "Please tell me if my pension plan is okay, if it complies with the tax laws.” This is actually very good for the Revenue Service. The Revenue Service has an opportunity to review most of the retirement systems in the country, private-sector, to help them comply, because that's really their mission. Their mission is not to collect taxes in this area, their mission to help them comply, to get the documents in order. So the Revenue Service gets the private-sector, gets the taxpayers to do things right; and the taxpayers know, in a very complicated field, that they are doing it right. It gives them substantial assurance.

We don't do that in the public sector. We don't do that for the reasons that I described. We don't do it because the Revenue Service doesn't understand, because the processes don't work, because the public-sector systems are quite concerned about this. And there is a process for the private sector to fix things, the corrective process. And that doesn't work very well, either.

Now, how are these things set up? These were set up -- all these processes were set up by the Revenue Service through its administrative process.

Do we know they work for the private sector? Sure.

Do we know that they are supported by the Congress? Absolutely, yes.

The most recent piece of major pension legislation has a section in it that says, "We support what you're doing with the corrective process, and we want you to continue." But it does not work for the public sector.

And I think that that's very unfortunate. We have a situation where we have people at this end of the Revenue Service and people at that end and the retirement systems; and it would be a value -- substantial value -- for both to get together and to work this out. And there's nobody who is pushing that who has taken the lead and that's what I think you folks can do. I think you can be the catalyst to get that going.

Now, there is no revenue involved. When you talk to the people in the federal side, they always ask, "Gee, is there revenue loss? Is there evidence that it's going to lose taxes?" And the answer is, no, not at all. The proposal is administrative, to make the world work better, and give greater assurance to both the Revenue Service and to the retirement systems, which means to all the members of the retirement system, and frankly, to reduce costs on people like me. Why bother paying me to do this kind of thing if you can actually get it done through a different process?

So I think that the Commission's role in this is to state what the best policy is. And from my perspective -- and this is on page 12 of the handout -- from my perspective, the best policy is to assure both the Revenue Service and the retirement systems that these systems are in compliance with the tax law.

And the recommendation that I propose is that the Revenue Service develop, in conjunction with the public-sector retirement systems, a corrective process, so they can go in, they can get fixed, they can get compliance. They don't have to worry about large penalties or losing a tax-exempt status, and move forward and get this behind them and get everybody in compliance in a manner that is cost-efficient.

And as I said, I truly believe that the Commission has a special role here, that you can actually act as an excellent catalyst. You can't get it done yourself, but you can act as an excellent catalyst to get this done.

Any questions about this?

(No audible response)

MR. BLUM: Okay, well, let's turn to the second most important part of this, which is back on page 25, Retiree Health.

Now, I want to talk about investment of assets, which is on 26. We have public-sector retirement systems that, in California and elsewhere –– but let's just focus on what I know about, which is California -- public-sector retirement systems that are extremely successful in investment of their assets, and they hold large pools of assets. And by "large pools," I'm not talking just about CalPERS or CalSTRS, but the '37 Act systems and other large agency retirement systems such as the City of Los Angeles and the City of San Francisco and the City of San José have large pools of money. When I think of "large pools," I'm thinking of anything from four or five to eight billion dollars.

Now, agencies are going to start putting money into what I call OPEB trusts, trusts that hold money for retiree health care, health benefits. It will take quite a while for most agencies to build up a trust of any size. A hundred million dollars in an OPEB trust these days would be a lot of money. A hundred million dollars in the investment market, I'm sorry to tell you, is not a lot of money. But if the hundred million dollars could be pooled easily, without tax barriers, with other investment monies, where there already is substantial success -- specifically, pension-pooled monies -- if I could put OPEB monies together with pension monies on a voluntary basis, only if you want to do it, that could increase the net return for the OPEB money, reduce the cost of investment, and increase the amount of money available to pay this benefit -- which seems to me to be of substantial value. I don't know of any reason why you would not want to do that, again, on a voluntary basis.

But the tax laws have a barrier to this. The tax laws allow the pooling of money in this manner only for certain very specific types of sourced money. Specifically, tax-qualified plans, something called 403(b) plans, IRA, and also, interestingly, the trust which is being held by the Pension Benefit Guaranty Corporation.

Now, this comes out of old administrative rules from 1956. And gradually, over the years, and with some sense that there's really some value for doing this, the Revenue Service has expanded the ability to pool the money. But I cannot pool money -- and I'm going to give you a technical phrase -- I cannot pool money under a 115 trust with money that's from a qualified plan. The Revenue Service says, "Forget it. That will disqualify, lead to taxation of the retirement system." You certainly don't want to do that. So that just doesn't make sense, frankly.

I have a situation where roughly the same pool of people will be receiving the benefits. The money is being held in both circumstances to be paid on retirement. In one circumstance, it's paid as pension, and another circumstance it's paid as health benefits. The money can certainly be accounted for properly. We can do something called -- I can give you another technical term -- we can do something called a “unitization," which sets up an accounting process, so everybody knows whose funds are whose. All of the money must be held solely for the benefit of participants and beneficiaries. The money is not going to be used for some commercial venture or for some other reason, other than to provide these benefits. And there is no revenue loss, because a 115 trust is tax-exempt, and pooled money of pensions are tax-exempt. Why not allow them to be put together?

And I think the answer is because no one has asked yet.

Now, the Revenue Service may say “yes,” the Revenue Service may say “no”; but there are very sound policy reasons to allow this to be done and there is no revenue loss.

Now, this is not the only way to do this. CalPERS has got a pool of health-care money. What I understand they're doing is what's called "parallel investing," which is different from pooling. And in talking with different people who administer and deal with investment monies, I'm told that parallel investing sort of works. It's not as good. The money managers don't like it. They will sometimes charge you more. There are issues about what you can really do with parallel investing. It certainly can be done, but it's not as good. It's not as smooth. It's certainly not as efficient as actually commingling all the money and investing it in that way.

So, again, what's the role of the Commission? The policy that strikes me should be that best-practice investments should not be prevented by the tax laws, by the Revenue Service, unless there's a strongly overriding tax policy, of which I know of none.

So if that is the policy, then it strikes me that the recommendation is easy. The recommendation is the Revenue Service should allow retiree health-care money and pension assets in the public sector -- there's reasons not to do it in the private sector -- in the public sector, to be invested together for sound funding of these benefits.

Those are the two most important recommendations. If you were successful in getting the Revenue Service to establish a process so we could have clear tax compliance and understanding on both sides -- Revenue Service and retirement systems -- and if you could get commingling of assets without a tax barrier, those two would be enormous successes for California retirement systems and members of those retirement systems.

Now, do you have any questions about that one?

CHAIR PARSKY: Let me just ask a question because the second recommendation is driven, from your standpoint, by the ability to generate higher returns?

MR. BLUM: Yes.

CHAIR PARSKY: Why would that necessarily be the case? Because it's not necessarily the case that size brings better return.

MR. BLUM: At a minimum, because the cost of investing will be -- as a matter of basis points per dollar, will certainly be lower with a large pool of money.

CHAIR PARSKY: So it's the cost side of it, not the ability to necessarily achieve a gross better return?

MR. BLUM: Well, there's two things that would happen: Your costs would go down, and you would probably have access to more sophisticated money managers.

CHAIR PARSKY: Matt, do you think that's necessarily true?

MR. BARGER: Well, if you have a hundred-million-dollar fund, you probably can't afford to have the best -- you can’t get into a lot of these funds --

MR. BLUM: I couldn't hear.

MR. BARGER: You can see, people have done the separate accounting, like the City of New York does it in five different accounts so you can do it, certainly, but it would be more efficient to do it the way you're talking about.

MR. BLUM: Sure.

CHAIR PARSKY: Bob?

MR. WALTON: Thanks.

Bob, I think you make a very strong argument for your points.

I know from the public sector there's a risk involved. And the risk is not getting the right opinion from IRS. There's a risk in asking.

MR. BLUM: Yes, there is.

MR. WALTON: And what's the risk in asking if you get an adverse opinion?

MR. BLUM: On which of the issues?

MR. WALTON: On the latter.

MR. BLUM: On the latter?

Right now, we know what the answer is because we've talked with them.

MR. WALTON: Well, but you haven’t got a letter. But it doesn't count until you get a letter.

MR. BLUM: Well, let's put it this way: When they tell you over and over in conversations that there is no way they will give you a letter, it's usually not worthwhile asking for the letter unless, for some reason, you actually have to have that piece of paper in hand. We've actually gone through this in the last four or five months with a retirement system that wanted to do that; and the Revenue Service said, "Forget it."

You know, if you read the rules as they are now, it really is clear. And let's be technical for a moment. The issue is, what you can put in an 81-100 trust? And the answer is, you cannot put retiree health-care money into an 81-100 health-care trust unless it's 401(h) money, which this is not.

MR. WALTON: So if they can't now, what would change? What are you recommending would change --

MR. BLUM: I think that --

MR. WALTON: -- to allow that?

MR. BLUM: Again, I'm going to use jargon for a minute. 81-100 is a revenue ruling that was established by an administrative policy.

MR. WALTON: Correct.

MR. BLUM: Not established by laws of the Congress.

MR. WALTON: I understand.

MR. BLUM: 81-100 can be changed by the Revenue Service if they wish to do it -- that would be the Revenue Service and Treasury, obviously -- but if they wish to do it.

Now, why would they want to bother; okay? And the only reason they would want to bother is because they would think that there is no adverse tax policy impact, there is no revenue loss, and it's good policy.

Now, you may think they don't respond to that, but I do. I think they do respond.

MR. WALTON: Well, then if it's that logical, why don't they just do it?

MR. BLUM: Oh, come on. You have to have a catalyst to get it going.

MR. WALTON: Well, my experience with the IRS is they don't act logically, and there's a big risk in asking.

MR. BLUM: Well, I hear you. What I'm saying is, that I don't think there's any risk in asking on this one, because we've asked. And I think that -- I won't tell you it's uniform, by any means, but I have had substantial success in getting positive response. There's no guarantees.

CHAIR PARSKY: I guess, Bob, one of the main points you're making is that it's one thing for a, quote, “interested party” to ask for something --

MR. BLUM: Yes.

CHAIR PARSKY: -- and it's another thing for a disinterested Commission to shine a light on the fact that it covers the three points you make.

MR. BLUM: Yes, yes.

CHAIR PARSKY: Teresa?

DR. GHILARDUCCI: It would make sense for our commission to act on this if there is a big problem. I mean, we -- and I'm not saying that there isn't -- but we haven't heard any testimony from employers or people who are not getting their tax break that they want. But that doesn't mean that we shouldn't move; but I want to get some sense of the magnitude of the problem.

We also should probably do something if somehow public employees are being treated worse than private employees in similar circumstances for no good reason except historical accident.

So I just wanted to make sure I understand your testimony. The big problems for public employers and employees is that when they go to repurchase past service, they often have to pay more tax than a private-sector employee would have to do.

Two: That if an employer wants to rehire a retiree -- your example was for training purposes they run up against, you know, what ERISA calls this -- what's it called? What is it called?

MR. BLUM: Separation problem.

DR. GHILARDUCCI: Separation problem, even though private employers are making too much of it, actually, they can get around it if they want. But you're somehow saying this is a problem in California. And then there's this issue that, I don't know if I understand it, that the public employee has a tax risk if their agency is classified as a different kind of government entity than a previous one.

Can you talk a little bit about, in sort of plain language and numbers of people affected, to the Commission about if we did act to say there should be parity, how many people would we help out, how many public employers is this a problem for? Because we've had no other evidence but from you that it was.

MR. BLUM: Sure. And the issues that you've raised are separate issues from the ones that I've just asked. So let's go through them very, very quickly.

For those of you who participate in public-sector retirement systems, you know there's such a thing as purchase of service or redeposit. When somebody leaves and he or she takes a refund, takes the contributions from the system, then there's a forfeiture of all benefits provided by the employer. On rehire, that person can buy back in, can repurchase that service, and in some circumstances, can buy additional service credit. For example, military time or prior public service time.

Under present law, that can be done pretax. And that's because of a statute that was enacted in 1974 in ERISA. And I can tell you that that was a political deal. ERISA would not have passed without that statute.

The Revenue Service has never been comfortable with it because it is different from what happens with the private sector. In the private sector, in fact, you cannot do this. So the Revenue Service is not very happy about it; but for the last 12 years, they've issued hundreds of rulings, saying you can do it. All of a sudden we're told, "Stop, forget it."

Now, how many people does this affect? It affects everybody in every retirement system in California who takes a refund, who withdraws his or her money from the system, and then wishes to buy back.

Can I give you precise numbers? No.

Bob may have a much better sense from his experience at CalPERS than I would have. But I know that just one small system that I'm talking with now, it's hundreds of people.

Bob, do you have any sense as to how many people buy back in?

MR. WALTON: No, actually, I don't because you would change circumstances. And, you know, we know how many people -- PERS knows how many people refund each year, and then you know how many people redeposit, and so you can get on a sense of that number. But how many would make that decision if tax laws apply differently? I don't know.

MR. BLUM: But everybody who redeposits would be adversely affected because they would have to pay more.

MR. WALTON: That's correct. And whether that would change their decision or not…

MR. BLUM: That part, we don't know. We just know that they would have less money in their pocket to buy, to reinstate their pension.

MR. WALTON: Correct.

MR. BLUM: It would cost them more.

MR. WALTON: Correct. But when they retire, a part of their retirement, a larger part of their retirement is going to be already taxed, and their taxes will be less in retirement.

MR. BLUM: Right.

MR. WALTON: So an individual can make a different decision based on their own circumstances.

MR. BLUM: My sense is, it's frequently an immediate cash-flow decision.

MR. WALTON: Sure.

MR. BLUM: People in the public sector don't make that much money. And to the extent you can save money at the outset, that's what people look for.

So that's one issue. What's going on there is the Revenue Service is changing its position. There's been no change in law. You know, that will be fought. And the question is, is it something that the Commission wants to raise and say to the Revenue Service, "We think essentially you're off base, you shouldn't be doing it, there's been no change of law," or is that something that you want to let somebody else to go after? That's one issue.

I'm sorry, I need to get that back in mind to get all the issues that are here.

DR. GHILARDUCCI: The separation and then…

MR. BLUM: The separation issue is -- there's really two things going on with the separation issue. It all involves a concept called “normal retirement age," which is very important for public safety officers and health benefits, retiree health benefits, as well as being very important for the way that retirement systems operate. This concept fits in several places. So normal retirement age is a concept that's in the Revenue Code for private-sector plans and not really for public-sector plans.

We don't have, in many California systems, we don't really have a, quote, “normal retirement age.” We don't write the plans that way. They don't operate that way.

Well, Congress passed a law last year that allows retired public safety officers to have up to $3,000 of their pension used tax-free to buy health care -- enormous value -- but only if they retire after normal retirement age or are on disability.

How in the world do you know if you retire after the normal retirement age in California? We don't have that concept. It's very ambiguous.

What that means is that either the retirement systems will establish a normal retirement age, which most likely will be higher than most public safety officers think is appropriate, or -- and I think this is what's really going to happen -- many retired public safety officers will be at risk from a tax perspective. Very inappropriate.

Now, who does this affect? It affects every public safety officer who has retired before the age of 55 and not on disability in California. Every single one of them. I said 55 because that's a safe harbor for 55.

Now, what about the separation? There's

another rule that's keyed around normal retirement age that says you can't get your pension if you are working and it's before normal retirement age. And if, by the way, the retirement system pays that pension, the retirement system can lose its tax-exempt status. Not a good thing.

So what happens? And I hear this over and over from my clients at counties. What happens is that somebody gets ready to retire, they have someone designated to put into that position. Under the civil service laws, can't put that person into that position until the -- the new person -- until the old person leaves. The old person leaves. The old person comes back and trains the new person. There's no separation from service. That's a tax-qualification issue. That's very uncomfortable.

People do it, but it puts the retirement system -- which means everybody in the retirement system -- at risk. So these are barriers that frankly should not exist.

But, again, from my perspective, these are important, they're somewhat lower level than those first two that I talked about. The first two were really global.

CHAIR PARSKY: Any other questions?

(No audible response)

CHAIR PARSKY: Bob, thank you very much.

Oh, I'm sorry, yes?

MR. COTTINGHAM: Mr. Blum -- actually, we had some conference calls on it because we were dealing with some legislation for our association on the normal retirement age which, again, like you say, can adversely affect the public safety officers. Because one of the things in the discussion is, in HR 4, the discussion of a plan, retirement plan versus a retirement formula.

MR. BLUM: Right.

MR. COTTINGHAM: And that even though this was designated as a public-safety benefit, that if a normal retirement age is established, that it would have to be established for the entire plan; it can't be set by the plan contractor. You would have to reestablish the entire plan, which would include everybody, which could greatly skew that normal retirement age.

MR. BLUM: Correct. That is one of the issues that if we were to dig into normal retirement age, I think that's a critical issue. I think that to the extent that the Revenue Service would take the position that you can only have a single normal retirement age within a plan which covers both safety and general members or miscellaneous members, I personally think that's wrong, I think it's bad policy; and I think that's the kind of thing, if the Commission were interested in recommending policy to the Revenue Service on this one, I think that that's one that, in fact, should be addressed.

MR. COTTINGHAM: Essentially, that wouldn't just affect just California, that would affect all the systems of the United States because they're all under that same guideline. Because some of these are definitions in the way they've defined it as opposed to actual code. So we could actually ask for a clarification or a change of language on, as you said, 81-100, and for some clarifications in HR 4.

MR. BLUM: I think that you absolutely can ask for clarifications with respect to the HR 4 as well as the 81-100, yes.

MR. COTTINGHAM: Because I think there was a previous incident where they were not going to consider self-insured health plans as being eligible for the benefit. And then on a simple -- well, not a simple inquiry -- it came through a Congressman for a request to the Treasury, stating there would be legislation that they change their guideline on that.

MR. BLUM: Yes, yes. So it was clear that they will change when pushed.

MR. COTTINGHAM: And, actually, they changed without having to do actual legislation.

MR. BLUM: Right.

MR. COTTINGHAM: They just decided to do it through the Treasury Department.

MR. BLUM: Yes.

CHAIR PARSKY: Lee?

MS. BOEL: We should talk about the domestic-partners issue.

MR. BLUM: You want me to talk about domestic partners? Okay, very briefly.

Domestic partners. The domestic-partner issue is one that is new from, again, within the last six months. It comes, and it affects retiree health care. And it affects not only people who have domestic partners; it affects -- could affect everybody who receives a benefit, a retiree health-care benefit under a plan that covers domestic partners.

Now, I have to tell you, I find it very bizarre -- and we had substantial arguments with the Revenue Service about this -- but they were adamant, and they have issued a ruling -- it's a private ruling -- but they have issued a ruling to the effect I'm going to describe.

Their rule currently is that if a single individual in a health plan, a retiree health plan has a domestic partner and that domestic partner can receive retiree health-care benefits, that the only way that everybody -- not just that couple -- everybody in that health plan can have tax-exempt benefits the way everybody anticipates they will be. The only way that can occur is if during the working lifetime of the employee who has a domestic partner, income is taken into account -- is reported on a W-2 every year equal to the value of the retiree health-care benefit for the domestic partner that is earned that year.

Now, it's bizarre, okay, but this is the ruling. And it comes out of their interpretation of the revenue ruling that was issued in the year 2006. 2006-36 is the number of the Rev. Rule. I understand where they're coming from. I absolutely understand what their policy issue is and why they're doing this.

The problem is from a tax-policy perspective -- forget for the moment about domestic partners, about California law -- from a tax-policy perspective, this is bizarre. And it's bizarre because how in the world do you measure it? How in the world do you know that somebody is going to have a domestic partner at the time of retirement? And if you take this money into account, if you really do, in fact, report it as taxable income, when the money is paid in retirement, that then is tax-free, and that's the policy.

Well, let's take a modestly aggressive tax position. If this is the rule and we should have been doing this for the last -- let's just take a number of years -- 20 years, there's a three-year statute of limitations in terms of reporting income on the 1040.

And so maybe I've not been doing this, but that's okay, nobody can go back and try and open up for my tax return for three years beforehand. So when I go retire, I'll just take income, the value in income for the next three years. When I go to retire, hey, the income -- the amount of money that's paid for my domestic partner coverage is tax-free.

Well, this is silly.

So we have a situation where you can't value it, it's extremely bad policy, and it loses money for the Revenue Service. Why in the world would you do that?

I can tell you why you'd do that. You'd do that because the policy is being made at a mid-level of the Revenue Service, and it's not being challenged. And that's unfortunate.

So if the Commission wishes to take this on, frankly, the proper policy, I think, is that you tax the person who has earned the income, the retiree, on the value of domestic-partner tax benefits. That's clear under the Revenue Code at the time it's paid, and that's when the Revenue Service picks up its proper tax, and that's when you know how much the value is. And you don't jeopardize -- because their rule is, you jeopardize, otherwise, the health care, the tax status, the health-care benefits of everybody else.

Now, that's something that I think the Commission, if it wished to take it on, could bring to the attention of the Revenue Service and point out that it's bad tax policy.

Now, one more issue, one more thing you need to know: I do not believe that this is being driven by some social policy of the Bush Administration. I just absolutely don't think that's happening. I haven't heard a thing about that.

What I've heard is good, solid, very narrow, with blinders on, mid-level Revenue Service people who say, "Oh, this is the logical extension of Rev. Rule 2006-36." They’re not thinking social policy. And, in fact, they're not thinking. Pardon me.

CHAIR PARSKY: One more question, Lee.

MR. LIPPS: Yes, Mr. Blum. Many school districts self-insure their medical benefits for their employees and retirees.

Could you flesh out some of the details on your slide number 28 relating to retirees who are covered by a self-insured health plan --

MR. BLUM: Sure.

MR. LIPPS: -- and how that is taxed, or how that can be taxed?

MR. BLUM: Sure. This was another surprise that came from the Revenue Service. We had a ruling before them that was what we considered to be a very simple, standard retiree health-care program, which said, "Okay" -- this is for firefighters –- "if you worked for ten years, you vest in 50 percent of the benefit. If you worked for 15, it's 75 percent," et cetera. 100 percent vesting after 20 years. And the benefit was not just the payment of premiums for Kaiser or some other fully insured plan; the benefit was payment for any medical expenses that were deductible under section 213, plus premiums. So these are, quote, "self insured." That's a technical phrase again, trying to avoid too much of the technical phrases. And we felt that that was just fine. It was collectively bargained, it was negotiated, signed off.

And the standard through the Revenue Code is, and every place else: If you have a bargained benefit, that's okay.

We were told that's not how they read the language for a critical section of the Revenue Code on health care. And we were very surprised. And we went back to it and went through it with them, and they said, "No, no."

And their problem was this: Their problem was people who stay around longer tend to have higher incomes. And if they have higher incomes, that means that they're going to get a better benefit than the people with the lower incomes, and the statute is designed to say that you cannot, quote, discriminate, cannot give a better deal for people who have higher incomes.

So they said, you know, "If you want to keep what you have, we'll give you a ruling, and we will tell you that the top 25 percent of the earners in that unit, in that bargaining unit, will be taxed."

And we said, "No thanks. We'll find a different way to do it."

And we had a number of discussions with them about what is "high pay." And, again, they are reading these rules in an extraordinarily narrow way. And, again, the policy is being made at mid-level, without people who are really thinking about what the issues are here.

So, once more, from the Commission's perspective, if the Commission wanted to take this on, it strikes me that the policy is that the Revenue Service should not interfere and prevent or put barriers into a situation where you have a benefit which is negotiated between an employer and employees in good faith, signed up in a bargaining agreement MOU, and fits with standard tax policy, because that's what standard tax policy has been since 1974.

And, by the way, in terms of the language, the exact language in the Revenue Code, we think you could get either reading of it. There's no reason for them to go where they went.

CHAIR PARSKY: Bob, I think as we move forward in developing recommendations relating to the tax here, I think the question that Teresa raised, I think, will want to develop the impact that these recommendations may have on California pension funds overall, so that we can categorize -- as we make recommendations, the larger the impact, your two major issues, for sure, we will want to make sure we can in some way quantify.

Thank you very much. We really appreciate it.

MR. BLUM: Thank you.

CHAIR PARSKY: Okay, we're going to move now into some further staff reports.

Tom, are you ready for that?

I think what we'd like to do now is to indicate now -- Tom, are you going to go first or is Grant going to go first? Tom?

We're developing a number of case studies which can serve as an important framework for the ultimate report. And Tom is going to kind of give us an example of that. And then Grant will talk a little bit about -- a little further on what's happening in other states. And then we'll come back and talk about a few issues before we conclude.

MR. BRANAN: Well, Mr. Chair and Commissioners, I'm actually only here to add a little glamour to the proceedings.

CHAIR PARSKY: Well, is that why you asked to follow the tax area; is that it?

MR. BRANAN: Yes, I figured that I couldn't go wrong.

CHAIR PARSKY: That's good.

MR. BRANAN: Actually, we will be talking on two things. Grant will be talking about what is going on in other states, and Admas is going to give the first three of our case studies that you've heard discussed. And I think we've decided Admas was going to go first.

CHAIR PARSKY: Okay, Admas. Thank you.

MS. KANYAGIA: Okay, good afternoon.

For those of you who don't know me, my name is Admas Kanyagia. I worked this summer as a graduate student intern with the Commission. And they've given me this wonderful opportunity to present to the Commission today as I end my summer internship. So I'm very appreciative of that. But I'm here to give a preliminary glimpse on the project that I worked on this summer, which is the case study project.

So in terms of the presentation today, I was just going to give a brief overview of the case study project and how we came around to doing it, and then present three case study profiles: The City of Thousand Oaks, the County of Alameda, and Western Municipal Water District, a small water district in Riverside, and then talk about the next steps for the report.

Please feel free to interrupt me if you have any questions, either on the text or on the content.

I was hoping to have some staff members from the individual cities or counties or districts here, but I think only one attended, Catherine Walker from ACERA.

CHAIR PARSKY: Is Catherine here?

MS. KANYAGIA: Hi, Catherine.

And she's available for differential questions, if Commissioners do have any.

So the purpose of the case study project was to document a range of approaches that different public employers across the state had used to address pension or OPEB strategies. We really didn't want to endorse one approach but really show a variety of different models that have been used by public employers in California.

In terms of methodology, what we did is we worked with Commission members, with agency staff, and also just to try to solicit participants to offer to be part of the case study project. And all participants who will appear in the report are doing it voluntarily. I couldn't force them to do it.

And then we really made an effort to have agencies of different sizes, from different geographic regions, and had multiple strategies. And we solicited the information using both written surveys and a series of informal interviews.

So far, we hope to have a projected 23 city, county, and/or special districts represented in this study. And then we will also be having my other colleague, the other graduate student intern who worked for the Commission this summer, Crystal Robinson, will be doing ten profiles on different school districts.

So today's presentation will just give some preliminary results. And we hope to have the report completed and available to the Commission by October of this year.

CHAIR PARSKY: One thing I would say, I think the Commissioners should keep in mind as you hear this, that as we move forward to try to develop recommendations, one of the things that I would like all of us to think about is in areas where there may not be one solution, we may want to think in terms of presenting best practices or elements of these case studies that would identify what has been done in certain bodies that has been quite positive as a way to kind of come forward with recommendations that policymakers ought to be thinking about.

MS. KANYAGIA: Yes, I'm very glad you said that. That's exactly the purpose of the project, in order to inform the Commission, as you move forward with the recommendations.

So the first case study profile I'll be talking about is the City of Thousand Oaks. And, first of all, I'll start out with a brief overview of the benefits that are offered at that particular employer, and then talk about the strategies that they implemented.

The City of Thousand Oaks is located in Ventura County. And as you can see from the slides and from the presentations in front of you what the benefit formulas are, the City of Thousand Oaks is a participant or a sponsor in the CalPERS system, so participating both for pensions and for retiree health care. Since they're in the CalPERS health benefits program, health-care benefits are pooled for both actives and retirees. But due to rising health-care costs, the City decided to cap retiree health-care premiums at $435 a month. The cap was also enacted for actives, but actives have an opportunity to participate in a cafeteria plan, which retirees do not.

And so to date, the City has decided, due to rising health-care costs, to start to look at how to address rising OPEB costs in the future.

In terms of vesting and eligibility, the City follows the general CalPERS requirement in terms of vesting for both pensions and health care. But because of the PEMHCA statutes and because of its participation in CalPERS, health-care benefits are considered vested in the City of Thousand Oaks.

So how did Thousand Oaks assess its OPEB liability? The City, as I said, had been looking at increasing health-care costs for a while, but in 2006, decided to conduct an actuarial study that identified a $22.8 million liability.

They later conducted an additional study in 2007, and decided to compare two funding options. One was the pay-as-you-go system that they were currently using, and the other one was prefunding. But not just prefunding alone, but prefunding with an initial, substantial investment. And the number that they picked was $6 million.

So as you can see in the chart, they compared the two in the actuarial study. And in terms of the pay-as-you-go method, normal costs were currently set at about $900,000. And with the pay-as-you-go system, the study found that they would rise to $1.3 million in five years. Because it was a pay-as-you-go method, it was subject to a lower discount rate. And their annual required contribution or ARC would start at $2.3 million, but would increase in time. And that would give them an unfunded liability at that point in time of $22.8 million.

When they compare that to the second method of funding, which was prefunding but with an initial substantial investment, the $6 million was well above their normal costs and whatever annual required contribution they had that year. But prefunding would allow you to use a higher discount rate, thus reducing their annual required contribution to $1.13 million, and really stabilizing it. It would only rise to $1.2 million in five years. And that would give them at that point in time an unfunded liability of $17 million.

Why Thousand Oaks is really interesting is because it shows this example of somebody who is trying to prefund, but prefunding with an initial substantial investment. Again, the idea of putting down a larger down payment in order to have lower mortgage payments in the future.

So the City decided on the results of this study to prefund and to prefund with an initial substantial investment of $6 million. And they reviewed several different options, but decided to go with the CalPERS Employers' Retiree Benefits Trust Fund, also known as CalPERS Health Trust Fund.

So the City became the first public employer to enroll in CalPERS' Health Benefit Trust Fund. The trust fund, as I'm sure you've heard before, was established to give a funding mechanism to public employers for addressing OPEB costs. Even though the trust fund was created in 1988, it was not enacted or activated until March of this year, with Thousand Oaks being the first participant.

So the fund is subject to the same rate of return as CalPERS PERF. There are no minimum contributions for employers to participate, and employers can make withdrawals when needed.

As Mr. Blum mentioned earlier, there is parallel investing with the Health Benefits Trust Fund, but the investments are made similar to the PERF; but one area is that they avoid illiquid investments in order to allow employers to make withdrawals.

Currently, only public employers that contract with CalPERS are allowed to participate in the program, but there's legislation looking at how to add -- allow additional public employers to participate. And that would increase the program to a potential 6,000 public employers in the state of California.

So the City of Thousand Oaks made that initial contribution of $6 million this year and became the first employer to participate in CalPERS' Health Benefits Trust Fund.

One of the questions that we really hoped to ask in the case study was: What were the motivations for prefunding and what were the budgetary trade-offs that were taken in order to make substantial investments?

We found with the City of Thousand Oaks, since they had been looking at addressing rising health-care costs for a while, they had actually been putting away money over a six-year period into fund balance reserves in order to address the OPEB liability. And at the time that they made the initial investment, that they had built in the cost of the OPEB liabilities into user fees and utility fees.

So all future contributions to the trust are set at the City's ARC. And the City is very excited, I guess, in order to stabilize all future OPEB payments in the future.

So this is an example of a new funding mechanism for OPEB that's available in California within an established pension system, which is CalPERS.

Any questions?

CHAIR PARSKY: Any questions?

MR. PRINGLE: Yes.

CHAIR PARSKY: Yes, Curt?

MR. PRINGLE: Yes, just a couple. We were chatting about what was the motivation with Thousand Oaks kind of taking this preliminary step; and, secondly, one of the elements of uniqueness that you found is that they did not have any public safety membership in their retiree pool; is that correct?

MS. KANYAGIA: Yes, well, the City of Thousand Oaks doesn't hire any safety employees. They contract with the County of Ventura for safety services.

One of the questions we did not ask is how retiree benefits for that contract might -- you know, has potentially affected the cost of that contract, and it's something that we can definitely look -- you know, ask them again.

But in terms of their motivation, I think it was just primarily due to rising employment costs, and kind of seeing this large, looming picture in the future. And the fact that they had been setting aside fund balance reserves for six years is really evidence that they were seeing this impending -- you know, large cost coming at them. It just took them a while to figure out what mechanism they would choose to push for.

MR. PRINGLE: And as you put together all of these -- and eventually there will be a matrix, I'm sure, so we can kind of see different movements of what similar agencies have done -- could you include things like the annual general fund budget of these agencies, the number of current employees, and the number of retirees that would be participants in that system?

MS. KANYAGIA: Yes, that is what we hoped to include in each profile.

MR. PRINGLE: I see.

MS. KANYAGIA: Because we wanted to give an idea of the size of the particular city. And we tried to pick a variety of different sizes.

MR. PRINGLE: Sure.

MS. KANYAGIA: So we have the Western Municipal

Water District who has 12 retirees to the County of L.A. with 85,000, I think.

MR. PRINGLE: Right. So what is the annual budget of Thousand Oaks?

MS. KANYAGIA: Actually, I don't have it with me right now, but those numbers will be provided.

MR. PRINGLE: Okay, thank you.

MS. KANYAGIA: And what we also asked the employers to give us is, what their employer contributions to pensions, if they had that information, was, as a percentage of their total operating budget. And we hope to represent that within each profile, again, looking at whether or not pension costs have been a significant part of their budgeting processes over the last couple of years.

Oh, yes. Yes, we do have that.

Were you asking as of today? Would you like to see their annual budget numbers today?

MR. PRINGLE: You don't have it right with you so that's okay. We can get it later.

MS. KANYAGIA: Yes, we've collected it. I don't have it right with me, but it will be included in the case profile. I just didn't include it in the presentation.

MR. CAPPITELLI: I have a question.

CHAIR PARSKY: Yes.

MR. CAPPITELLI: And I want to commend you, I think you've done a stellar job as an intern.

MS. KANYAGIA: Wait until you read the report.

MR. CAPPITELLI: Great job.

This is really a question for Commissioner Walton, because I'm curious from a historical perspective. This fund, this PERF was established in 1988 and been activated this past year.

What was the genesis of that and why was it not used? I was curious.

MR. WALTON: I have personal knowledge of that history.

MR. CAPPITELLI: I imagine you do, sir.

MR. WALTON: Dave Elder, did Dave leave?

Dave gave a brief history. He was the author of that bill back then, when he was chair of the Assembly Retirement Committee. Tom was there at the time. And I think it's important to remember -- and this is the underlying basis on why it wasn't implemented -- the retirement system, the retirement program is a separate trust, a separate program from the health program. The health program has its own operating budget and is subject to the Department of Finance, the legislative process on an annual basis.

So when this bill passed, it was determined that it was going to take significant amounts of dollars to implement. You have to have an actuarial staff, you have to do all these valuations. That's something that wasn't within the health program.

And so we went through the Department of Finance, the Legislature, to get budget authority to implement that bill. And the shorter answer is, we were denied. And it wasn't progressed until recently under GASB that that authority was given and monies were found, and so forth and so on. That's the short answer.

MR. CAPPITELLI: And just so I understand clearly, the hope here or the goal here is that the more entities that contribute to this, the larger the pool, the larger the return, the greater the benefit, et cetera; is that the --

MR. WALTON: Certainly. And you spread the risk of the pool, the larger it becomes. It's the same advantages you see in the retirement side to properly funding the retirement benefits, you'll reap those same benefits on the health side.

MR. CAPPITELLI: Okay, thank you.

CHAIR PARSKY: Matt?

MR. BARGER: The one other thing that you note that's unusual about them is they cap the retiree health care at a fixed cost. So when they're sitting there, making their assumptions about inflation and health-care costs, they don't have to, they're just a fixed number. So that's a very unusual situation.

MS. KANYAGIA: Yes. And I think that that might be something also interesting to point out when we complete -- in the conclusion of the case study report, is the entities that actually set the benefit at a premium cost or a specific plan cost versus those who just picked a specific allowance or subsidy, and whether or not that has made it easier or harder in making the decision to address the OPEB liability.

MR. BARGER: Yes, thank you.

MS. KANYAGIA: But, yes, they've set it at a certain subsidy. And whatever the difference between the premium payment and the subsidy is borne by the retiree.

CHAIR PARSKY: Dave, do you have a question?

MR. LOW: Just when you issue the final report, it would be helpful -- you have a column here saying, "Pay-as-you-go." But really, what that is, that's what the ARC would be if they didn't put any money in.

MS. KANYAGIA: Yes.

MR. LOW: Which is different from what the cost to the agency would be on a pay-as-you-go basis, which would be the cost of that capped premium on an annual basis, so it would be helpful to have that as a separate line, because that's a totally different issue.

MS. KANYAGIA: Okay.

CHAIR PARSKY: Okay.

MS. KANYAGIA: Okay, great.

Next, we'll move on to the County of Alameda. And I'm sure you are all aware, the County of Alameda is an independent system, one of the 20 '37 Act counties.

The retirement system in Alameda County is the Alameda County Employees Retirement Association, or ACERA, which administers the defined benefit plan for all county employees in Alameda. Described is the pension systems benefit formulas and the investing eligibility for pensions in the presentation. But as you can see, the net assets that are held in trust for ACERA, at the most recent evaluation, was about $5.2 billion, and the fund is considered 85.5 percent funded for pensions.

In terms of OPEBs, what's different about the County of Alameda is that retiree health care is not considered a vested benefit. So the county itself does not provide retiree health care to its retired employees. But all funding of retiree health care comes through the retirement system, so through ACERA, and specifically through the Supplemental Retiree Benefit Reserve. That's the SRBR. And I'll talk more about that in the next slide.

But retirees receive a monthly medical allowance or subsidy. And the amount of the subsidy depends on their years of service. So if you have 20 or more years of service, 100 percent of your premium is covered, and so on.

So what is the SRBR? Under Article 5.5 of the '37 Act, any of the 20 '37 Act counties have the option to adopt the article 5.5 provision. And what that does, is to create a supplemental retiree benefit reserve, the SRBR. To date, only two other counties, apart from Alameda, have elected to adopt this option: That's Kern and Tulare. But it is completely available to any of the other 17 of the 20 '37 Act counties.

So what the SRBR is, is that after funding various reserves that are required by law, 50 percent of excess earnings can be placed into this reserve for the use of the retirees and their beneficiaries. And here, we're defining "excess earnings" as net surplus earnings over the actuarial assumed interest rate.

The other 50 percent of what is defined as excess earnings can be placed into an account for the employer or employee to count against employer-employee reserves for future pension contributions. But the SRBR creates a potential source for funding of retiree health care.

The law grants all discretionary authority over the SRBR to the Board of Retirement. And as of 1985, Alameda County has been using its SRBR to fund retiree health-care benefits.

In addition to retiree health-care benefits, the SRBR includes benefits for things like COLAs, Medicare supplement plans, and death, vision, and dental benefits.

And as I described before, SRBR funding is limited to 50 percent of net surplus earnings over the actuarial assumed rate of return.

ACERA semi-annually credits this 50 percent to the reserve and the other 50 percent, as I mentioned before, can go towards counting against pension contributions for the employer or employee.

As of 2006, over $500 million was available in the SRBR for use for retiree health-care benefits. And the most recent actuarial valuation found that the post-employment medical leave benefits program, which is a subaccount under the SRBR, was 79 percent funded.

I think when I looked it up right before this meeting, Alameda County's unfunded liability is about $118 million which, in comparison to other counties of its size, is significantly less.

The report also mentioned that they can fund their health-care benefits until 2023 using this particular reserve.

So federal tax rules require that all post-employment medical benefits be paid out through a 401(h) account. So Alameda County has a very unique relationship with ACERA in which the county makes contributions to a 401(h) account. And ACERA, in turn, credits the County for pension contributions with monies from the SRBR or the post-employment medical benefits subaccount.

There's no requirement, though, that the employer, the County itself, put money into this 401(h) account, and ACERA does not have the authority to demand that it does. And perhaps one interesting thing to look at is why the County continues to have this unique relationship with ACERA.

But here, we see a very successful utilization of the use of pension fund excess earnings to address OPEBs. And, again, there's a lot of other examples around the state of California that we will be including in the report, and the different approaches that they have used to address this issue of excess earnings is very interesting.

Any additional questions?

CHAIR PARSKY: Dave?

MR. LOW: So my understanding of this account is that the benefit is only available to the extent that there is money in the excess earnings account?

MS. KANYAGIA: Exactly.

MR. LOW: So then wouldn't the GASB reporting requirement be zero?

MS. KANYAGIA: Yes, because it's not technically a vested benefit.

MR. LOW: Okay.

MS. KANYAGIA: Okay.

So then I'll talk about the very last example –- oh, I’m sorry.

CHAIR PARSKY: Sorry, yes, go ahead.

MR. COTTINGHAM: A question. Of the twenty '37 Act counties, only two use the 5.5?

MS. KANYAGIA: Right.

MR. COTTINGHAM: And as you said in Alameda, there's no requirement -- I guess the GASB liability they have is because they are contributing to the 401(h); would that be correct?

MS. KANYAGIA: No, they have none because technically retiree health care is not considered a vested benefit from the employer itself.

MR. COTTINGHAM: Okay, but that's the way it is through all the ‘37 Acts, and the other '37 Acts still are reporting a GASB liability.

And maybe this is also a question that, since Mr. Palmer is here that he could maybe address, because couldn't the other 18 counties, couldn't they use their 401(h) account in this same manner? Because there is a similarity in the fact that both of these are designed -- can be used to put money away for supplemental benefits.

MS. KANYAGIA: I think what you mean, instead of 401(h) account, you mean the SRBR.

MR. COTTINGHAM: Yes. The other 18 counties, instead of having an SRBR account, that they could use the 401(h) account in this same manner.

MR. BRANAN: I don't know if Bob's coming up or not, but --

MR. COTTINGHAM: Yes, I think he is.

MR. BRANAN: Other ‘37 Act counties do that. But the difference with 5.5 is that it formalizes what's often a year-by-year arrangement of sharing excess earnings.

So under 5.5, everybody knows, once the required fundings within the system are done, everybody knows 50 percent of that is going to go to the retiree account. But as far as making kind of the trade you're talking about with the employer paying part of the health care and the retirement system reimbursing them, that does happen in some counties.

MR. COTTINGHAM: Okay, thanks.

MR. PALMER: I think the piece here is that the SRBR, the 5.5, is taking as its funding source excess earnings over and above the required reserves that are necessary. And those monies then come into this particular trust fund, which is half of it -- excess earnings is 50-50. 50 goes onto the other side, towards the employer. This side goes to the retirees.

Now, the County is still taking the position that they are not responsible for funding the retirees. There is no vesting. And, therefore, they're not responsible for funding, they're not vesting. Therefore, they have no GASB responsibilities. And that's where we get back to Admas's position with them, is that there is no GASB requirements for the County, yet there is this funding source taking excess earnings into this reserve that then is, what, 71.9 percent funded, I think by your latest study.

MS. KANYAGIA: Yes.

MR. COTTINGHAM: What is the other criteria they use in the other 18 counties for putting into the 401(h) account?

MR. PALMER: Those funds in other counties go for a variety of things. They go for ad hoc benefits, they go for STAR COLAs. They don't have to go towards health insurance. It's really amongst the other 18 systems how they want to use their excess earnings. This one is very unique. When the County adopts a 5.5, it's very clear that 50 percent will go for the betterment of the retirees. And Alameda County, their position is they're using it for health, vision, I think I heard you say, death benefits, so it's very clearly earmarked that those excess earnings are being routed for those specific uses.

Other systems when they have excess earnings sometimes come up with ad hoc or sometimes permanent benefits under the '37 Act. And those are generally added to the retirement check itself rather than paying for health care. At least that's historically how we've done it.

MR. COTTINGHAM: Okay, thank you.

MS. KANYAGIA: Thank you, Bob.

If we're done with all questions on Alameda County, I'll move to the third case study profile, which is Western Municipal Water District, a small water district in Riverside County. We tried really hard to get representations from special districts. And we continue to work very hard to get them to be represented in this study. But we were very successful with getting the assistance of the Western Municipal Water District.

As you can see, pension benefits are what the pension benefit formula is set at. But what was very interesting for this district was their motivation really came from the opportunity to retain and recruit additional employees, especially for managerial staff. This is one possible case where, you know, if there's a way that we could study it in the future, we could see whether or not their decisions in addressing OPEBs have affected recruitment and retention. But their program has only been in existence for one year.

So they are a sponsor or participant in the CalPERS system. So, therefore, both pensions and retiree health care are provided through CalPERS.

In terms of OPEB costs, again, due to rising health-care costs, retiree health benefit premiums are capped at the lowest plan. So this is one case where the actual benefit is capped at the lowest premiums rather than at a specific allowance or subsidy, which currently is about $743 a month.

The district always funded retiree health care on a pay-as-you-go basis. But they found that over a six-year period, they had a 150 percent increase in health care for retirees.

Health-care benefits are considered vested for the district.

In 2005, the board really looked at competition between other special districts for managerial staff, and then also the associated rise in employment costs. And retiree health-care benefit costs were considered a really important factor in employee recruitment and retention. So they commissioned a study to look at their GASB requirement and identified an unfunded liability of $5.8 million is it.

Subsequently, the board decided to fully prefund the $5.8 million, and placed it into a VEBA trust.

Now, you've heard of VEBAs before, but they stand for -- VEBA stands for the Voluntary Employees' Benefits Association. It's very similar to a 401(k). It's a tax-exempt trust that can be used to pay eligible medical benefits. Listed under the IRS Code 501(c)(9), it can be used to provide the payment of, quote, "life, sick, or accident or other benefits to members." Membership in a VEBA is defined by, quote, "an employment-related common bond." So it must consist of individuals who are entitled to participate by the reason of being employees.

All contributions are made to the VEBA on a pretax basis, and contributions are allowed to grow tax-free. And all withdrawals from the VEBA, as long as they're used to pay medical expenses or reimburse for medical expenses, are also tax-free as well. And the VEBA does meet GASB guidelines of being an irrevocable trust.

So in this case, we see the district itself set up the VEBA and fully prefunded the VEBA from its own resources.

But in the case study report, we have other examples of other employers in which the employers have made no contributions, but set up the VEBA for the employees themselves to make contributions. So we have a variety of both types.

So the board decision to create the VEBA really came from two main motivations. One, again, the importance of retaining a strong and loyal employee base was important to them; and also they reported that they really saw addressing their OPEB liability as part of their financial success and financial planning.

Their VEBA account, all investments are managed by a third party, in this case, U.S. Bank. But all management, administrative, and development costs were borne in-house by the District.

And the board has since paid its first annual required contribution for the VEBA trust, and is committed to paying its ARC for the life of the trust.

And as I said before, it's really too early to see changes because the VEBA has only been in existence for a year. But this might be a very interesting case because it seemed like a lot of their motivation came from the fact that they wanted to ensure that they would always have retiree health-care benefits for staff at the District.

So here, we have an example of kind of a federal tax-exempt vehicle that's available for public employers to use to address OPEBs.

So I wanted to take this opportunity really just to thank the following individuals who assisted me to learn all this stuff to make it in the presentation today, but also to develop it for the report. But we have Candis Hong, who is the finance director from the City of Thousand Oaks; Chuck Conrad and Catherine Walker, who are here today from ACERA; Pat O'Connell from Alameda County; and John Rossi, Kevin Mascaro, and Phil Rosentrater from the Western Municipal Water District. They spent a lot of time and shared a lot of their expertise with me. And I'm really appreciative for that.

Any questions?

CHAIR PARSKY: Thank you very much for doing this and for your contribution.

MS. KANYAGIA: Thank you.

Questions?

CHAIR PARSKY: Yes, we'll ask some questions.

MR. BARGER: Actually, it was kind of interesting that they chose to fully fund it up-front. So I was sort of curious what their motivation was. And then a related question which I forgot to ask about, ACERA is over what period of time they were planning to fund their deficit in the OPEB liability. Because you've got one, obviously, that's doing it immediately and one that's planning to do it over some period of time.

MS. KANYAGIA: Wait, I'm sorry, can you repeat it? Do you mean for ACERA --

MR. BARGER: The Western Municipal Water District funded it 100 percent.

MS. KANYAGIA: Okay, 100 percent.

MR. BARGER: Up-front, whereas ACERA, if I understood you correctly, prefunded a small part, but still has a liability that they were going to amortize over a period of time.

MS. KANYAGIA: I'm sorry, are you talking about ACERA or the City of Thousand Oaks?

MR. BARGER: Excuse me, the City of Thousand Oaks.

MS. KANYAGIA: The City of Thousand Oaks? Yes.

I think that the CalPERS Health Benefit Trust is amortized over a 30-year period. So their initial contribution of $6 million, I think comparatively over the years, would reduce their liability in 30 years -- or probably it reduces their ARC over time.

MR. BARGER: But they're still amortizing over thirty years?

MS. KANYAGIA: They’re still amortizing over the period, yes.

And then you had another question about the Water District.

MR. BARGER: Why now, versus why the way of doing it over 30 years?

MS. KANYAGIA: They had an extra $5.8 million. But, again, I think that this is a place where maybe size really matters, and having 12 retirees and $5.8 million makes it a much easier opportunity.

And I think also special districts, what we're finding, have resources sometimes that other public employers don't have. So they're able to build it into utility fees much easier or do benefit assessments with property taxes. We have one case of a special district doing that. So I think sometimes special districts have easier access to resources, especially for employment costs than other public employers.

CHAIR PARSKY: Teresa?

DR. GHILARDUCCI: Why would the Water District use a VEBA and not the CalPERS trust fund?

MS. KANYAGIA: I don't know. Actually, that's a very interesting question.

DR. GHILARDUCCI: Yes, because I'm sure CalPERS could get a better rate, lower administrative fees than U.S. Bank.

MR. WALTON: They started before the CalPERS trust fund was in existence. They started back in '05.

DR. GHILARDUCCI: That's it? Is that the difference?

MR. WALTON: I don't know of any vehicle that would allow them to transfer, now that they're in a VEBA, to the CalPERS trust. That may be something we need to take a look at, but I don't think they can do that.

CHAIR PARSKY: Curt?

MR. PRINGLE: But isn't it also true, if CalPERS doesn't administer their health plans, if they're not -- that is the issue with our city --

MR. WALTON: Certainly.

MR. PRINGLE: -- for example, and that is why I know there's a bill pending in the Legislature, 554.

MS. SHEEHAN: Yes.

MR. PRINGLE: The point is there are others. One of the issues we were talking about with the creation of that whole trust fund and why it hasn't been used -- I mean, there are a lot of other smaller agencies that don't necessarily have CalPERS administer those health programs.

MR. WALTON: I think going back to Paul's question earlier, in 1988, there wasn't GASB 45. And I think that's the genesis. There was nothing to preclude public agencies from prefunding benefits, ever. They could always set up their own bank account and put money away, do actuarial valuations. But I think GASB 43-45 brought sunshine to this issue, and that's what's led down the path that we're at now. I think that's really the genesis of it.

MR. BRANAN: Mr. Chair?

CHAIR PARSKY: Yes, Tom?

MR. BRANAN: Mr. Chair, I think there's one other factor to keep in mind as to why some agencies choose PERS and some don't. And that is historically the relationship between contracting agencies and PERS has not always been a happy one. And there are agencies that maybe not on a rational financial basis are choosing not to use PERS just because of past history.

MR. WALTON: Let me cut to the quick, too, also on this subject and why many school districts don't use PERS. I think less than 10 percent of school districts use the PEMHCA program, and that is because the PEMHCA law requires the employer to cover retirees as well as actives. And so many of those that elect not to be in PEMHCA do so because they're not required to cover retirees. And not only cover them, but cover them at the same contribution amount.

So if I, for an active employee, make a $700-a-month contribution, I also have got to make a $700-a-month contribution to a retiree.

MR. LOW: Eventually.

MR. WALTON: Eventually. It can grow over 20 years, but they have to be equal over time. And many employers simply don't want to cover their retirees, and that's why they're not in the PEMHCA program.

CHAIR PARSKY: Are there any other comments, Tom, that you had?

MR. BRANAN: No.

CHAIR PARSKY: We’ll shift over to Grant.

MR. BOYKEN: Good afternoon. I'm Grant Boyken with the California Research Bureau. Mr. Chair, Members, thank you for having me.

Admas's report just discussed what's going on in California. And today, I'm going to give a little bit of a discussion about how other states -- state and local governments outside of California, what they've done to address some of the similar issues that have been brought before you at these hearings.

And next slide, please.

The reforms that I've looked at, by looking at summaries of legislation in other states and talking to experts, the reforms really kind of break down into three categories: Plan design of retirement systems. In terms of both health and pension benefits, benefits have been reduced, employee contributions have been increased, plans, both health and pension plans have been changed in a way to try and lower the cost, pension plan provisions such as cost-of-living adjustments, the way the calculation of final compensation is made has been changed.

In terms of funding, a number of strategies have been tried across the nation, including changing actuarial methods in order to reduce contribution-rate volatility, establishing pension and retiree health-plan changes that would shift a greater portion of the risk and cost to employees.

And in terms of governance, a number of strategies, legislation had been tried in an attempt to increase oversight, accountability, and transparency.

Obviously, there's a really wide range of what's been tried out there. And it is just not possible to cover it all. So through consulting with your staff and sort of my own observations about what issues or what ideas have been brought to you and where your interests seem to lie, I've decided to focus on three topics. And I want to just preface this by saying that the hybrid pension plans, OPEB prefunding, and actuarial oversight, by bringing these up, I'm not necessarily saying that this is the direction you're headed. I'm just sort of reading where the interest has laid, and trying to sort of add to the conversation that way.

The first sort of reform idea that I want to talk about is hybrid pension plans, alternatives to sort of the traditional DB plan. And I'd like to preface this by saying that the majority of public retirement systems still have defined benefit plans. About 90 percent of public-sector employees have a defined benefit plan as their retirement -- as their primary pension plan. But in recent years, in the wake of the market downturn, a number of alternatives have been considered. And even though a handful of retirement systems, a handful of states have established mandatory or optional stand-alone DC plans, the focus of my presentation today is really on two other types of plans that are kind of a twist on the traditional DB plan. One is the so-called blended plan, which combines -- both of these types of plans combine elements of both the DB and the DC.

The blended plan -- and I'm not sure if that's a term that is used beyond something that I made up, but it's something that makes sense. It blends a DB component, along with the DC component. And the way that the works is that typically there is a smaller DB benefit, which is funded by the employer, and then there's a DC component as well that's funded primarily by the employee. And then the second sort of model is a cash-balance plan, which is, in essence, a defined benefit plan. The difference is that it sets up an account. Sometimes it's described as a hypothetical account for the individual employee. And the employee and employer contributions go into the fund. And at retirement, the benefit is based on the contributions made for the individual employee, as well as a guaranteed annual interest rate with which the account is credited. And so it's based on that, those contributions and the interest rate rather than like a traditional DB plan: age and years of service.

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So before I get into why those plans have been adopted or some of the pluses and minuses, I just wanted to give you a couple of charts. The first one describes some of the features of the kind of blended plans that I've found. If you look under the column for the DB multiplier, the retirement formula, if you will, they're all somewhere in the neighborhood of 1 percent, a little bit higher. And if you compare that with the formulas, say, in California under the defined pension plans that we have, they're about half for state miscellaneous employees. There's a multiplier of 2 percent at age 55. And that's double what these are. So there's a smaller defined benefit component. And then in terms of contributions to the defined contribution component of these plans, as far as employer contributions, it can vary. In some cases, such as Washington, the state of Washington, there is no employer contribution. In some cases, it's an election.

And with the federal system, there is a 1 percent mandatory contribution. But then the government also matches up to 5 percent of the employee's salary, if the employee -- it's an incentive to get the employee to contribute a higher amount in the DC component.

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This is sort of an outline of the cash balance plans that I was able to find. I'm sure there's more out there. But through consulting with the National Association of State Retirement Administrators, and just poking around on the Web, this is what I've been able to come up with.

As you can see, California under STRS has a cash balance plan for part-time teachers. Some of the features of the cash-balance plan, you can see that both employees and employers contribute. With the Texas county and district plan, what I've given there in the table is the weighted average for all employers and employee groups that are covered under that system, but employers can elect to contribute at different levels. The guaranteed interest rates vary somewhat.

For the California part-time teachers plan, the individual accounts are credited at 5 percent annually amend, 7 percent for Texas county and teachers. But the Nebraska plan has a minimum of 5 percent, but then it fluctuates with how the market is doing as well.

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So the question is, why have these plans been looked at and implemented? And there's a number of reasons, probably. As far as the blended-type plans, one of the advantages to employers is that with the smaller guaranteed benefit, the magnitude of employer contribution rate fluctuations is probably going to be smaller. In terms of cash balance plans, some of the benefits that have been looked at are the portability factor. Just like a DC plan, a lump-sum payment, if an employee is ready to leave and switch careers and go to a different employer, they can take a lump-sum payment, roll that over into a qualified account. So it's much more portable than a traditional defined benefit plan.

And one of the other appeals is that's how it sort of acts like a DC plan, but it is still a defined benefit plan, and the funds of all the employees are pooled together for investment purposes, which avoids some of the high fees associated with the individual accounts in a defined contribution plan.

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Some of the other features that have been looked at is that in these plans, employees share some more -- some of the risk and cost is shifted to the employee. In a blended plan, obviously, in the DC component, the employee bears the risk of market ups and downs.

And in a cash-balance plan, such as the one in Nebraska, where the annual interest rate change is based on the market, some of the risk is borne by the employee as well. And another thing that's sometimes pointed to is that hybrids can have -- they have incentives for keeping employees working longer. With additional years of service, employees only accumulate more in their accounts. And because a lot of these accounts either have as an option or some mandatory -- as a distribution option, employees receive, rather than a lump sum, they receive an annuity. And with an annuity, because the amount of your annual allowance is based on your age, there is an incentive. The annual allowance is higher for people who retire at a later age.

I think the open question is, well, how do the benefits compare? A lot of the features that are talked about are kind of the employer-friendly features. The question is, how do the actual benefits under these plans compare with the traditional defined benefit plan?

And I think for some of the blended or hybrid plans, it probably really depends on how those plans are structured. It might vary depending upon what the guaranteed interest rate is, what employee and employer contributions are.

One thing that I didn't really touch on yet is when these plans were established -- I meant to do that when I showed the chart -- but for the blended or cash balance plans -- if you want to back up two slides, if you can do that -- or one more, actually -- the Indiana plan and the federal sort of blended plan, both of those are the exceptions to the other three in that they were established in -- at least the federal plan in the 1980's. But the Ohio, Oregon, and Washington plans were established in 2002 and 2003, so it was after the market downturn. Obviously they were established largely around some of the concerns about pension-funding issues.

And then the next slide, on the cash-balance plans. The Texas plan has been around for quite a while. The Nebraska plan is sort of an interesting story, in that ever since the 1970's, Nebraska had a self-directed, sort of investment, basically a DC account or a DC plan for state and county employees. And sometime around the year 2000, a benefit-adequacy study was done. It was done by Buck Consultants. And what that study found was that I believe it was teachers who were in the state's defined benefit plan had -- they compared how the people in the defined benefit plans fared compared to the state and county employees in the defined contribution plan. And they found that the DC folks fared much more poorly.

And the major factors for that were that the majority of people in the DC plans left their funds in the sort of conservative option, investment option that didn't earn a lot. And then there was also the matter of higher fees for those folks. And so that was the impetus for Nebraska to reconfigure their plan for state and county employees and come up with the cash-balance plan.

Okay, could you move on to two more, prefunding?

I'm not going to touch a whole lot on the different types of trust accounts. That's been talked about some. But I just wanted to give an overview of what's going on out there in other states in terms of prefunding OPEB benefits. And the first thing that I would like to say about that is that if you look at the surveys that have been done, it appears that, more than anything, there is uncertainty out there about how local and state governments will approach OPEB -- unfunded OPEB liabilities and if they decide to prefund, how they'll go about doing that. And I just wanted to give the highlights of a couple of surveys. One was done by the International City and County Management Association last fall -- so about a year ago. And it found that, you know, the majority of local governments were really unsure about what they were going to do in response to the GASB requirements and OPEB unfunded liability. And about 80 percent, if you look at those last two bullets, 80 percent either did not plan to consider prefunding or were not sure. Now, likely, a year later, that's probably changed quite a bit.

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Last June, there was a study done by AON Consulting. And this has probably changed as more states have done their OPEB evaluations. But that study found that 23 states had completed their OPEB valuations. And 12 had either submitted legislation to establish trusts to prefund retiree health in OPEB, or they have already had trust funds of some sort enacted.

And, again, 401(h) -- looking at the literature, looking at what's out there in other states, it seems that three options, in terms of trust to prefund OPEB liability come up. One of those, it's already been discussed earlier today, is the 401(h) account, separate account that it's done in conjunction with a pension fund. It's got some limitations. As I understand it and as I've read, it can only be used for retiree health benefits, not for other sorts of post-employment benefits.

And another limitation is the contribution limits. Contributions are limited to, as was discussed before, to 25 percent of the pension contributions. So if no pension contributions are made, then contributions can't be made to the 401(h) account.

And just to give one example, Ohio has actually had a 401(h) account established since 1974.

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VEBAs: Admas's presentation had some discussion of what VEBAs were. I recently spoke with -- well, a lot of public-sector plans, especially those done by smaller employers, are handled rather than through -- are handled by a third-party administrator. And I've spoken with a couple of third-party administrators who kind of gave some of the trends in terms of local governments setting up VEBAs to prefund OPEB benefits. One of those is that still the most common source of contribution is accrued sick leave at the time of retirement.

So a lot of the plans, a lot of the VEBA plans that are still out there have not really been set up to address or to fully fund at some point in the future OPEB liabilities, but they're a way to provide additional funding through benefits that have already been accumulated: Sick leave accrual.

But the VEBA administrators have said that the number of local governments and state governments going toward a VEBA, looking at VEBAs seriously as an option to prefund throughout an employee's career, is on the rise.

And then section 115 trusts have been mentioned today as well. And some of the states with the bigger trusts that have been set up include California, Michigan, Minnesota. There's some others out there, and this is changing quite frequently. But one thing that I wanted to mention on the heels of Mr. Blum's presentation is that a number of states, as I've been reading, have indeed secured IRS letters for their 115 trusts.

The last thing that I wanted to discuss is sort of the topic of governance. And as I think I mentioned in the introduction, a number of states have tried different sort of tacks to increase accountability, oversight, or the transparency of what pension systems do. Again, there would just be too much to cover for this presentation. But I wanted to sort of follow up on -- there was an idea that Keith Brainard from NASRA presented –- well, actually let me back up.

Several hearings ago, there was an actuary, John Bartel, who works with public employers in California, and he floated the idea of creating a panel of actuaries to review assumptions and methods for reports that are prepared for California public agencies. And then since then, I've heard Commission members follow up with people giving testimony about that idea.

So I decided to look into it a little. And in consulting with Keith Brainard from NASRA, I haven't really seen anything that mirrors that sort of idea, where there's a separate panel of actuaries that we've used, say, the reports that would regularly go to the Controller's office. But the one sort of unique idea that's out there that Keith Brainard had mentioned, was the Georgia Public Retirement System’s standard law.

Now, in other states, there are mechanisms through the legislative process where the actuarial impact obviously of retirement legislation is reviewed. But what seems unique about Georgia’s -- and then more recently Oklahoma has adopted a law that emulates what Georgia does -- what seems unique is that these laws, they formalize, or they make automatic sort of systematic review of pension legislation with a fiscal impact. So before it can go forward, a review has to be done. After that's done, no amendments can be made that would change the fiscal impact without having another review done. And then for any pension legislation with a fiscal impact, funding provisions have to be made before the law is actually -- before the change is actually enacted.

So I'll just end there. That's the last slide. And I'll open it up for questions.

CHAIR PARSKY: Questions?

Let me just ask, and maybe we can begin to engage a little bit with the commissioners.

Would you say, Tom, coming out of this is, the general concept of prefunding, as an overall concept, is something that you're really asking the commissioners to consider seriously, with the idea that there may be a number of different ways to go about prefunding? Is that what you'd like the group to go thinking about?

MR. BRANAN: Certainly, we think that the Commission should be aware of different approaches to prefunding and also to realize that in specific cases, prefunding may not be something that an employer would choose. But I would think that it's definitely something that we would like to have employers all over the state understand better.

CHAIR PARSKY: Comments about that from commissioners?

(No audible response)

CHAIR PARSKY: I mean, it seems to me that this is one major policy area that we ought to be thinking about making an important part of this report.

Teresa?

DR. GHILARDUCCI: Prefunding sounds like a great idea, very responsible, it's reflected in Georgia and in Oklahoma. It's certainly the policy of many other states and other countries, even though I can be persuaded by a local government's argument not to. So I can imagine that.

But I want to point out one other thing, is that the main difference between a VEBA and then what California is offering non-PEMHCA participatory government agencies is really a not-for-profit way to accumulate their money without paying for the fees of the commercial entities. So VEBAs are administered by commercial entities, and California has offered their public employers this other non-commercial route. So that does seem to be the material difference.

I also know in the industry, these VEBAs are a great, hot, new market for financial institutions.

One other -- just while I have the microphone, I just wanted to point out to Grant --

CHAIR PARSKY: You can keep it for a while.

DR. GHILARDUCCI: Thanks. I'm not shy about it.

CHAIR PARSKY: We know.

DR. GHILARDUCCI: Grant, the arguments you made for a hybrid plan versus a pure DB plan, you know, are pretty familiar, and we've seen those before. I just want to point out that the advantages of a DC model to encourage people to work longer has been really nuanced in the literature. Because you can structure a DB plan to encourage people to work longer, and we should do that, if we need to do that. But also the DC plans have these kind of perverse effects on retirement behavior.

Just think about it: When the market goes down and those DC accounts look really puny, you get a lot of people clinging onto their jobs when you wish they would leave. And the perverse effect is when the market is up, there is usually a big demand for employees to stay, and that's precisely when they leave because they get the illusion that they have a lot of money in their account and cash out when they can. So the retirement effects of the DC plan are more nuanced than what you stated, but even though it's a really good thing to not encourage people to retire when they don't want to and the employers don't want them to.

CHAIR PARSKY: Curt?

MR. PRINGLE: Mr. Chairman, back on your question there, from a personal perspective and from my government role, I think the whole prefunding discussion is good, and how can we encourage that and support that. I think those are all things we should be contemplating if there is a way that can be suggested or encouraged or brought about. But I also think one of the things I'd like to see in a final report is kind of an objective measurement of unfunded liabilities, a formula basis that all agencies can fit within with standardized assumptions. But in that same model, I also would like to see if some of those agencies, through that kind of a reporting or public disclosure model, would show kind of similarly what Thousand Oaks showed over a 30-year basis, what would certain things do to them in terms of, if you didn't prefund, what would that ongoing obligation be? If they did prefund it X percentage of their general fund -- you know, a few percentage -- what would then that affect? In other words, some way in which you could at least, within each of those public agencies, have a little more, I think, public discourse as to what does it mean for them to prefund at some level.

And, you know, I don't know what we will be able to do at the end of the day, how it will affect small cities like Thousand Oaks or large cities like Los Angeles; but one of the things that it may affect is just, as I think one of our mandates, is the level of public awareness on this issue.

And it's one thing to suggest, you know, the sky is falling or the sky is properly secure. But at the end of the day, I think it also might be nice to have the public and others see, okay, there are some things we could be doing in some of those choices available to us and not force every elected official or every human relations director to have to set out on their own path to try to figure all that out. If there is some kind of standard measure by which, okay, we've put it in and we ask them to chart out that 30-year payment program or what prepayment would be, I think that would be a service that all public agencies could receive as well as the public.

CHAIR PARSKY: Bob?

MR. WALTON: Certainly to follow up on that, I would hope that staff would be able to develop something along that line for both retirement and health.

We know retirement in virtually every case is a vested benefit. We know what the -- I think all pension plans know what their liabilities are, what percent funded. And that ought to be on a chart listing the amount, so forth and so on.

Health is a little more problematic. We're just now finding out what those numbers are. And one thing you have to determine is, agency by agency, do they consider the benefit vested? Like Alameda County doesn't, so there's no liability. But they have chosen to prefund a certain amount of money to set aside to pay for that cost in the future that isn't a vested benefit and there's no obligation to report a GASB 43-45 liability. So it becomes mixed. And so I think you have to have those categories broken down to properly show it.

For those that do consider it vested, yes, it ought to show, I think, at least two numbers. For liability, the number of the liability that without prefunding and the number of liability with prefunding, and what action that agency has taken. Because I think that's just part of identifying -- fulfilling one of our tasks, is identifying what the liabilities are for public agencies.

CHAIR PARSKY: Right. And by pointing out the difference between a prefunded approach and not, you can see how the differential in terms of the magnitude of the unfunded is.

MR. WALTON: Certainly. Because it’s really -- it would be a matrix because you can have a GASB liability and choose not to prefund.

CHAIR PARSKY: Right.

MR. WALTON: You can have no GASB liability but choose to prefund, and a combination.

CHAIR PARSKY: Well, if you combine that with what we may deem to be -- or what we could put forward as potential best practices that are used in a variety of different cases --

MR. WALTON: Right, exactly.

CHAIR PARSKY: -- that would be, I think, a public service also.

MR. WALTON: Exactly. And when you see the difference between the cost, the unfunded liability without prefunding and with prefunding, that's an important number to know.

CHAIR PARSKY: Absolutely.

MR. CAPPITELLI: Yes, just a comment on the same line.

As I kind of look at what you're asking and what we see in the future, maybe when we talk about prefunding, we can also include some of the examples of the testimony we've heard from prior meetings, where, you know, bonds -- you know, prefunding now, prefunding on an annual basis with contributions, et cetera, et cetera. And so we could break that down and look at -- incorporate all these best practices and some of the research into that. So I think you're on the right track.

CHAIR PARSKY: Matt?

MR. BARGER: I think it's an important issue just sort of from a principle point of view, too, which is, I look at this very much as it's important for us as a generation not to get the benefit of a lot of services and then pass the tab on to our children. And so there is a generational equity issue floating around as to who should pay when for the obligations. So I find for me personally that's an important principle, you know, as long as we're sort of touching on things related.

The second thing which is related to that is sort of using numbers to illuminate rather than disguise. And I think, you know, making recommendations and sort of best practices actuarially would be another sort of aspect of this that I think we need to address actuarially. I think there's been a lot of testimony about gaming of the system, both sort of from the employer's point of view, not contributing when they were supposed to, and those sorts of things; and then also gaming of the system from the individual retiree. And those are things that I think call into question the sort of fairness of the system from everybody's point of view.

So I think the recommendations in regards to what the best practices and recommendations to make, again, that should be part of what we're doing.

And then we've touched a lot on -- you know, we have sort of, in some ways, these big entities, like PERS and STRS, which do things, you know, in a large-scale way. I know certainly from the investment side, very professionally. I assume on the administrative side, equally impressively, trying to figure out ways to allow every district, no matter what size it is, either to follow those best practices or, you know, participate in it in some way, again, seems to be part of the equation to me. And it all relates.

CHAIR PARSKY: I think very much it does. True.

MR. WALTON: Gerry, One other point. I think from a member standpoint, I think a product that will be very important -- and we've heard this from member after member, retiree after retiree -- is identifying which agencies consider their health benefits vested and which do not. Because I think there may not be agreement, for lack of a better word, on that issue. But that's never been defined before -- at least I've never seen it defined before -- and also those agencies that simply don't provide retiree health care. Because I think the perception of the public is they all do.

CHAIR PARSKY: That they all do.

MR. WALTON: The fact is, they don't. A significant number don't.

CHAIR PARSKY: Yes, I think maybe a number of those suggestions, Bob, come under the category of getting the facts out there before the public.

MR. WALTON: Exactly.

CHAIR PARSKY: And both in terms of the magnitude of the obligations, and then that there are wide differences among various agencies.

MR. WALTON: Very well put.

CHAIR PARSKY: I think that could be a very positive part of what the Commission can do.

Yes?

MR. COTTINGHAM: When you talk about getting the facts out there in front of the public, I mean, right now, there's already disparate facts out there in front of them already that are skewed, as far as liabilities, GASB liabilities. When they report these out and, actually, what you find out when you look at it in the report, a GASB liability for health-care pension fund is X-amount of dollars. But if you look at the overall fund, that's probably -- some of them, it's less than 30 percent of their fund; some of it, it's less than 10 percent of their fund. But all you hear is what the liability is. So the public -- and that's being used basically against public employees. And it's an unfair analysis.

And I don't know if this Commission has thought about doing press releases in that manner, to explain some of these things, even before we come out with an actual formalized report, if that would be something within our purview. But I think that could be very beneficial, that this Commission could weigh in on part of those arguments because it is a skewed number that's out there.

CHAIR PARSKY: Well, I think we should think about what we do between now and the issuance of the final report, for sure. We want to be certain we have the facts before us, before we can make public. But I go back, I think it potentially would be very helpful, again, if there were best practices being employed, whether it's at the CalPERS level or at an individual agency level. And we can really highlight that and really urge upon the constituencies of local agencies that the state may have no direct control over. But their constituencies can, in effect, be able to identify what their agencies are doing or not doing. I think that would be very helpful in this process.

MR. COTTINGHAM: Yes, because we already have entities out there, and then from our side, it comes up in contract negotiations that are –- and one of the things we're exploring is GASB, that they're using GASB to browbeat their employees to say they have to totally eliminate retiree health care because of the potential liability they have in GASB; where we know by what has been presented and one of the things that you can do, you ameliorate that GASB liability by what you do in prefunding, trust, or anything else like that. So that's information that is not really getting out there on a widespread basis.

CHAIR PARSKY: I think you're right.

Bob, do you have another comment?

MR. WALTON: Well, along that point, Mr. Costa -- and I believe he's left also -- but he presented this information about “30 ways to spike your pension.” And to a large extent, I would agree, this is pension spiking, where you have an unplanned, not actuarially planned for, increase in compensation. But I know for a fact that what's in the PERS law, many of these, if not all of them, were specifically addressed. The PERS law doesn't allow a person to report overtime, it doesn't allow vacation buy-outs. And so the implication of this list is it applies to all public plans; and, in fact, I know it doesn't. But there can be best practices.

CHAIR PARSKY: Exactly.

MR. WALTON: These are done -- the member doesn't do this, the agency does this. That's how they report.

I don't know if it's still true, but there was at least one city that had 120 forms of special compensation that reported to CalPERS. 120. And we have the task -- they have the task now, I don’t -- but they have a unit at CalPERS that looks at these and determine, "Are they part of your normal pay, or are they outside of normal pay to determine whether they're properly part of your pay or not?" And that's ongoing. Because as quickly as you identify in law that this is or is not, there's new ones created.

MR. PRINGLE: Mr. Chairman, I think the discussion of this panel has transitioned now into our final topic.

CHAIR PARSKY: It has.

MR. PRINGLE: And if it hasn't, I'm going to steal that opportunity only because I have to leave in three minutes.

CHAIR PARSKY: We may finish in three minutes.

MR. PRINGLE: No, no, you won't. I'm going to take two and a half of it, but the --

CHAIR PARSKY: Have you been in the Legislature, ever?

MR. PRINGLE: We never had prescribed times for speaking.

But first of all, I want to say, I think the value of presenting best practices is a good value. And I think that showing that is good. I don't know if we necessarily will know it because, in fact, there are a lot of agencies that we're not going to include in our surveys, there's a lot of agencies that are doing things out there. So it's the best practices as we know them, presented in kind of a guide, and hope that people are encouraged to do that. But I guess that’s where I kind of hit a wall on the value of this commission. I think this commission has a lot of diversity of opinion.

And I actually believe there are a lot of controversial and difficult positions that could be taken by this Commission and expressed that wouldn't just be recommendations or guidelines but, in fact, kind of the direction of legislative change that we could get. And in many cases, if not unanimous, but very strong recommendation from the whole body. And I would hope that we would go beyond the concept of, you know, I think we should have a text and a guide and a presentation of best practices; but I'd also like to have, you know -- the only way you apply best practices is if you specifically state these best practices we want to have mandated in some fashion legislatively.

Some, I don't necessarily know, but I don't think all -- someone said not all plans can be directed by the state; but, in fact, I think they can be. I think almost any plan that is established in California through some -- pardon me?

MR. COTTINGHAM: I don't think charter cities and counties cannot be directed by the state.

MR. PRINGLE: Well, again, I did float through the Legislature for a couple years. And during that time, I saw a lot of gentle persuasion offered to those that want other funds or other activities or other state recognition. And, therefore, I believe in every instance, through state law, we can require certain best practices if the Legislature passes that and the Governor signs that. I think that those recommendations could be applied to every single entity.

Therefore -- I mean, I'd really like to ensure, Mr. Chairman, we do have some real specifics -- I know a lot of people are waiting with anticipation to see what comes out of this commission, and some have said that not much will.

I have always felt differently, because I believe at the end of the day, everybody here from the different perspectives we have, are fiscally responsible and are concerned with the employees that are providing service in local government structures as well as the state government across the line and those retirees that perform those services.

And there are questions about, you know, long-term impacts that need to be addressed. So I think there are a lot of good, challenging ideas that can be presented in a final report, hopefully with a lot of clear support. Maybe not in every case unanimous, but support. But I'd like to make sure that we do not overlook the great opportunity we have to pass on some very aggressive suggestions to the Legislature on ways to move forward with this issue.

CHAIR PARSKY: Well, I think you certainly make a good point. And I do think that everyone here would like this to be a meaningful report.

I think that maybe the way to move it forward -- and I didn't mean to suggest that identifying best practices necessarily are, in and of itself, will avoid addressing difficult issues. Because I think that you will find -- and one of the things that I did want to cover before we close -- was how we can move the report forward. And I think each of the next meetings we'll reserve most time to get on the table issues. Issues that perhaps we could immediately agree, collectively, should be out there as part of a recommended report; issues that you might think, Curt, are somewhat controversial, and they might be. Nevertheless, they may be addressed somewhere within our system in a relatively positive way. And by pointing out through the best-practices approach how those issues are addressed, we may be able to accomplish exactly what you want.

I'd like to at least put it forward to see if that can happen. And then at the end of the day, we'll have to see, are there any issues that this commission ought to be addressing that either couldn't be addressed because everyone could agree we should put this forward? I mean, the overall concept, for instance, of prefunding is a concept that maybe all would agree ought to be put forward. Whereas some other issue, we might have difference of opinion. But somewhere, we would have found, under the best practices, that the City of X address this in a way, and all we would need to do in order to, I think, provide a meaningful contribution, is to highlight how this was addressed.

So I think we should -- as I say, let's give it a little bit more time. I think at the next meeting, what I'd like to suggest is that we put some specific issues on the table and see which category they may fall in, see if the staff can come forward with, were these issues addressed anywhere that we have found in either our case study or survey? See how, and then get individual reactions to it, then see if we can't pull that together in a way that everyone can kind of endorse. That's the way I kind of see things unfolding from here. We may have one or two follow-ons, but in terms of input.

But my suggestion for us now is to move this into the category of issues that we want to get out on the table. And I would welcome, as we develop these agendas, commentary from each individual Commission member, get this issue out there. Let's talk about it and see whether we can fit it in within one of these two broad categories.

Does that seem to make sense here?

MR. WALTON: Gerry, is it your concept that we would, between now and the next meeting, submit those to staff?

CHAIR PARSKY: To staff.

MR. WALTON: And then they can organize them in a manner that can be presented at the next meeting?

CHAIR PARSKY: Exactly.

MR. WALTON: That doesn't preclude something else coming up. At least it's a start.

CHAIR PARSKY: Not at all. That's what I'd suggest.

MR. CAPPITELLI: Mr. Chairman, also to that end, I'm not really sure what you have on tap or what we have on tap for other subject-matter experts to come between now and the next few meetings; but I would suggest that we try to build in more time into our agenda for this type of discussion that we're having right now, because I think that's where we're at.

CHAIR PARSKY: We will. And that was what I was going to cover under this subject.

MR. CAPPITELLI: Great. Thank you.

CHAIR PARSKY: That's exactly what we have in mind.

MR. WALTON: Chair Parsky, one other point that just came to mind. There may be those that we might want to invite to attend the meetings -- subject-matter experts is what I'm thinking of. Not to make presentations. But when we start discussing these as best practices, we ought to get the experts telling us, “Yes, that's a good idea,” or “No, and here's why it's not,” because we're not experts in these areas, whether it's an actuary or investment or whatever. There's certainly enough out there I’m sure that would be willing to attend just to help us in this regard.

CHAIR PARSKY: I think that's a good idea, too. A very good idea.

Tom, any more guidance that you would have for this group?

I do think that in developing sections of this report, we're going to have to figure out the right way to kind of make sure that we all have adequate input in terms of the sections. But we'll come back with some thoughts about that.

MR. LIPPS: And, Gerry, if I could ask one other thing of staff.

Sort of along Bob's line of not wanting to make data-free decisions, would it be possible to -- I don't want to carry six binders on a plane. Could we get two full sets of binders to use as resources as we're going through discussions, and if we want to take a look at something like, I want to take a look at that curve for Peralta College and what the effect their OPEB bond was, rather than -- I don't mind bringing my notes, but I don't want to bring six binders.

MS. SHEEHAN: Yes, we can bring them.

MR. LIPPS: If we could do that.

CHAIR PARSKY: I think we can do that.

Thank you all very much.

We really appreciate it. And we'll see you at our next meeting, which is September 21.

(Proceedings concluded at 3:19 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 5th day of September 2007.

DANIEL P. FELDHAUS
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