STATE OF CALIFORNIA

PUBLIC EMPLOYEE
POST-EMPLOYMENT BENEFITS COMMISSION

PUBLIC MEETING

Friday, September 21, 2007
10:06 a.m.

University of California, Los Angeles
Physics and Astronomy Building, Room 1425
480 Charles E. Young Drive, East
Los Angeles, California

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

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A P P E A R A N C E S

PUBLIC EMPLOYEE POST-EMPLOYMENT BENEFITS COMMISSION

Commissioners Present

GERRY PARSKY, Commission Chair
Aurora Capital Group

MATTHEW BARGER
Hellman & Friedman LLC

PAUL CAPPITELLI
San Bernardino County Sheriff's Department

JOHN COGAN
Stanford University

CONNIE CONWAY
Tulare County Board of Supervisors

RONALD COTTINGHAM
Peace Officers Research Association of California

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

LEONARD LEE LIPPS
California Teachers' Association

CURT PRINGLE
Mayor, City of Anaheim

ROBERT WALTON
Retired (CalPERS)

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A P P E A R A N C E S

PUBLIC EMPLOYEE POST-RETIREMENT BENEFITS COMMISSION

PEBC Staff Present

ANNE SHEEHAN
Executive Director

JAN BOEL
Staff Director

TOM BRANAN
Policy Director

MARGIE RAMIREZ WALKER
Office Manager

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Public Testimony

DAVE GILLOTTE
Los Angeles County Firefighters

VENA M. MACBETH
California School Employees Association

ROSALIE A. PRESTON
AFSCME – Retired

IAN S. RUDGE

ROY B. STONE
AFSCME Local 2626, Librarians' Guild

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A P P E A R A N C E S

Presentations

CARL FRIEDLANDER
President
Los Angeles College Faculty Guild, AFT 1521

MICHAEL C. GENEST
Director
Department of Finance

MAC TAYLOR
Deputy Legislative Analayst
Legislative Analyst's Office

DARROCH "ROCKY" YOUNG
Former Chancellor
Los Angeles Community College District

--o0o—

Also Present

JASON DICKERSON
Principal Fiscal and Policy Analyst
Legislative Analyst's Office

TIM LYNN
Assistant Program Budget Manager
Department of Finance

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BE IT REMEMBERED that on Friday, September 21, 2007, commencing at the hour of 10:06 a.m. at University of California, Los Angeles, Physics and Astronomy Building, Room 1425, 480 Charles E. Young Drive, East, Los Angeles, 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: This reminds me a little bit when I was teaching high school. Now, Mr. Cogan at the other end, he teaches still.

Is this familiar with you?

MR. COGAN: Well, when I ask questions, you can rest assured, I'll be getting up in front and I'll give you a lecture with all of my questions.

CHAIR PARSKY: Well, we will just have to see, when you speak, how many notes are taken for the exam that will happen.

MR. COGAN: You mean how many of you are asleep?

CHAIR PARSKY: Not at Stanford; right?

This is a competitor institution, but we hold UCLA in the highest regard, at least at this seat.

In any event, I want to thank the campus for hosting us. We are going to have another hearing that we'll also have at the campus in December. But the UC system has been extremely cooperative to us, and we're very grateful for that.

This is the seventh commission hearing, and the subject today is *Defining Solutions for California*. It's really the beginning of the heart of our process.

We will have some testimony this morning, which is important that we'll continue our effort to bring forward subject-matter experts. And then we're going to spend the entire afternoon beginning to get input from Commission members and our staff on how to move in the direction of creating a final report.

At each one of our subsequent hearings we will be oriented now toward trying to get a structure, and then the meat, if you will, of the report.

So this will start a new phase of our hearings. We still will welcome, as we will this morning, public comment. We want that comment extensively. We've tried, to the maximum extent possible, to move around the state, have public hearings at different locations so that the public can come forward, listen to our deliberations.

This is an extremely important issue for the state. And every one of the Commission members have been treating it exactly that way.

I've started every hearing, and I really want to start this hearing, by reminding everyone of the purpose of the Commission and the direction that has been given to us by both the Governor and the legislative leaders.

The purpose for us is to identify the amount, or the magnitude of post-employment retirement pension and health-care liability in California so people can understand it and appreciate what I think all of the Commission members and staff appreciate, and certainly the leadership in our elective office appreciate, and that is that this is a serious problem that needs to be addressed now as opposed to being postponed.

Second, to evaluate approaches for addressing these unfunded liabilities and propose, in various forms, a plan to try to make sure that these liabilities are adequately funded.

The Governor and the legislative leadership have made it clear that promised pension and health-care benefits to existing employees and retirees will be met. A number of people have come forward expressing -- in the initial hearing, certainly -- expressing concern that somehow existing employees and retirees are going to be denied benefits that have been promised. That is not the basis upon which this Commission was established.

The elected officials that have control over that issue have made it clear that they intend to honor these promises.

Our job is to give them recommendations in light of that, as to what is the most prudent, fiscally responsible ways in which those promises can be honored. And I think it's important to kind of set that framework.

On behalf of the Commission Members, I've tried to do that at every hearing, and I will continue to try to that at the subsequent hearings.

So we'll move now into our public comment period.

Any comments that any of the Commission members would like to make before we begin?

(No audible response)

CHAIR PARSKY: Okay, so we have this morning five speakers. We'll try to keep the comment period to somewhere between two and three minutes, given the number of speakers. And, obviously, we would welcome the submission of any written material that our staff will take, and we will take into account.

So our speakers include -- I think it's pronounced Vena Macbeth and Dave Gillotte, Roy Stone are the first three speakers. So if they could come right to the podium here.

I hope I pronounced the names right.

Just say who you are, and that you can proceed ahead.

MR. GILLOTTE: Good morning, Mr. Chairman and Commission. And you did get it right, it's Dave Gillotte. I think you're the first person to ever do that, so I thank you for that.

Again, my name is Dave Gillotte, G-I-L-L-O-T-T-E. I'm the president of the Los Angeles County Firefighters, Local 1014. I represent nearly 3,000 active duty firefighters in LA.

I'm speaking here also as an active-duty 20-year firefighter. Still currently working line. About ten more years to go, 12 more years to go. And married, three kids. Wife doesn't work. That pretty much characterizes the bulk of the membership I represent for the better part of my 20 years.

I'm also here speaking on behalf of the Los Angeles County Coalition of Unions, which is over 50,000 workers, public-safety in nature: Sheriffs, life guards, secretaries, probation officers, attorneys, and medical interns.

I'm here to speak to you today solely about a subject that became political about two years ago, but I think is of significant import for the Commission to consider in post-retirement benefits, and that's survivor benefits for widows and orphans of public-safety members.

Every year, we have an upcoming memorial here on September 29th. I'm going up this year to Sacramento to the park to add, again, another well over 13, 14 names this year to the memorial of active-duty firefighters who died in the line of duty. And I know all public safety members do that as well for their career.

For those survivors who are here and whose relatives died during service, their sole support going into the future is the benefits provided by the pension system. Most of our LA County public employees are not part of Social Security. That's important. And even if they are, from a previous job, there's what's called a windfall offset. In fact, money is supplanted out of their pension. So it's not in addition to; it's in concert with, so it doesn't grow. Many people don't know that.

The federal and state benefits -- and what I'm speaking of includes the workers' compensation death benefits -- those are lump-sum, single pay-out benefits. And as you know, those can be eaten up quite quickly, and they don't sustain the spouse into the future.

So the sole annuity for the family to survive on, going into the future, is the pension system pay-out subcommittee health-care benefits or access to health care with those benefits.

Those benefits should always include access to health care, in our opinion. Oftentimes, it does not. And most of my employees -- and I think it's characteristic for the state -- those firefighters, in fact, their survivors, the sole access to health care has been through the spouse. They don't have plans on their own. For instance, my wife doesn't work. We wouldn't have health care if it wasn’t for me. So it would be hard for me to go out into the public sector and get health insurance after 20 years of fighting fires. It would eat up everything I have.

I'd like to give you a few stats here, to conclude, that will give you some value to what I'm speaking about, because that's the emotional part of it and you hear that a lot.

Between the '05 actuarial evaluation and the '06 LACERA actuarial evaluation, we had 99 active-member deaths. 99. We had 2,212 service retirements, 189 of those were disability retirements and 1,273 were retiree deaths without a beneficiary.

The average monthly benefit for survivors of active and retired members in all classes of employees at LACERA was $1,842 a month. I'll repeat it because it's staggering: $1,842 a month.

Most of you are familiar with the L.A. and Orange County area. That’s not a lot of money.

What's the cost for that? Most of you have been at the bargaining table, and at the end of the day, they ask what does it cost to fund something like that? And it's usually a percentage of salary.

To fund the monthly benefit for survivors of active and retired employees in all classes, it's 3.02 percent of active-duty payroll. 3 percent.

I teach my kids to save more than that for the future. I think it's an adequate investment, and I think it should be funded. The employer does fund that, and it's done through negotiations.

The average safety-plan retiree -- that's firefighters, police officers, and the public safety members -- that family will receive about $4,728 a month. 4,728. If the death is an active-duty firefighter or police officer, the surviving family will receive that full amount, but could, in fact, have reduced health-care benefits. And that's important.

If it's a retiree that dies, then they will receive 65 percent of that dollar amount, which reduces your monthly down to 3,073, but then they get full health care.

With the overall benefit payment being about

$2,898, the average benefit payment for retirees in 2000 to 2005 was $3,256. That gives you some idea of the impact of this. It's not that large, it's not that great, but it is for the family.

I urge the Commission to safeguard those pensions that provide the survivor benefits and the health care, because they're the only annuity for the surviving family and the children.

And I take personal stock in that, and then I call them “my widows and orphans” because I end up taking care of them. I've been a president for six years of the local, and been in the local for ten years, and I've dealt with over 13 families from my own job. And I continue to deal with them on a regular basis and see the struggles they go through. It's not pretty.

So I strongly urge the Commission to support keeping these benefits intact, and, of course, properly funded -- properly funded -- for my widows and orphans, for your widows and orphans.

I thank you very much for allowing me to testify here today; and I urge you to do good, diligent work in this.

Thank you.

CHAIR PARSKY: Thank you very much.

A person named –- is it pronounced “Vee-nah”?

MS. MACBETH: Correct.

CHAIR PARSKY: Even if it wasn't pronounced correctly, you still can speak. It’s perfectly okay.

MS. MACBETH: Thank you.

I'm proud of you, though. You said it right. Most people don't.

I want to thank the Commission for affording me the opportunity to speak to you today.

My name, as you said, is Vena Macbeth. I'm a classified employee, working for the Lancaster School District. I am also president of the local California School Employees Association.

As a classified employee, I'm here to address the concept put forth that public employees are riding a wave of excessive riches and bulging retirement benefits.

School employees provide the necessary services to educate California's future in a safe and productive environment. We do this primarily not for the money, but because we believe in public education, and we love what we do.

I continue hearing and reading about the cushy retirement plans public employees receive and that the plan should be reformed. Part of this latest so-called reform is to eliminate pension and retiree health-care benefits for all part-time employees. This would disqualify half of the employees in my district.

No matter how you look at it, this is not a reform, this is an elimination of employees who have devoted their entire lives to the children of California.

This latest plot also wants to exclude employees who are unable to work until the age of sixty-five and receiving employer health-care benefits.

So what happens to the custodian who took the 15-foot fall off the ladder, who suffered through two back surgeries? And yet in spite of all the pain, continued to work for an additional two years, until one day he woke up, and he had no feeling in his right leg or arm, and he could no longer lift anything heavier than five pounds?

After three doctors finally talked to him and convinced him that he had to take disability retirement, he did. He's receiving the district's health-care pension. He's 55 years old.

Does his service mean nothing?

Like the rest of this country, our workforce is getting older, and we're looking at retirement. And what we see is frightening.

Let's just imagine that I'm 62 years old and I'm single. I've devoted my life to the students of California, working as a six-hour paraeducator for

25 years. Because I am a part-time employee, my length of service is prorated at 18.75 years. My pension will be $961 a month. In California, and especially Southern California, that's not much to live on.

Now, add health care into the mix. My employer pays 90 percent of the insurance premium cap. There's a cap at 90 percent. The cap continues to stay as it is, but the premiums continue to go up.

I can't afford the health-care program I had as I was employed. I will have to take a less expensive plan that has a greater out-of-pocket cost for prescriptions and services.

I am a public employee, and there is absolutely no way that I can ever afford to retire. I won't survive on my pension.

It is the workers who have made this nation and this state what it is. We're a great nation. Yet for some reason, these workers are now facing hostile intentions from these who would have us work for nothing more than producing their profits. It's past time for the workers to be recognized and respected for their services we have and we'll continue to provide. Our pensions are not a gravy train. We earned them with our sweat, our toil, and our loyalty.

You have an opportunity to stop the assaults on our pensions and return some of the loyalty, respect, and appreciation to us: The working people of California.

Thank you.

CHAIR PARSKY: Thank you very much.

Roy Stone, Rosalie Preston, and Ian Rudge. Those are our three last speakers.

MR. STONE: Hi. We thank you for this opportunity. My name is Roy Stone. I'm the president of the Librarians' Guild, the librarians who work for the City of Los Angeles, and also here representing AFSCME District Council 36, representing approximately 20,000 public employees in the southern part of the state.

I don't have any numbers for you. But the concern is both for -- well, it was nice to hear your assurance that current employees will not be diminished in what we've worked so hard for. But the importance, especially as librarians, especially for the public good throughout the state, the workforce, we as public employees aren't getting rich, as you know. But one thing that can attract people are those benefits, to make them secure, to provide the retirement, the health plans after retirement, until the federal government does something for a national health plan, which we don't know if that will ever happen, to attract those people to become that stable librarian-providing force in every community, especially Los Angeles because that's where we are. This is one of those benefits that attracts people and gets them to stay in the profession, to get them to stay as public employees, providing those services in every community.

So we appreciate your time and hope that you will look at that broader view and plan for the future, so that we can maintain the stable workforce that keeps this one of the better states funding the way it does.

Thank you.

CHAIR PARSKY: Thank you very much.

MS. PRESTON: My name is Rosalie Preston. I'm a retired L.A. City librarian. I retired in January of this year at age 58, and I worked most of my career part-time. I am finding my defined benefits pension to be adequate for my needs, and I'm able to live comfortably, though modestly on $3,100 a month, less $400 a month for state and federal taxes.

But I am fortunate that I own my own home. That makes a big difference. And I am thankful for having this retirement and the health benefits that I do have, knowing of many older female friends who ended up on disability and struggle financially every day, often eating only one meal a day to get by, and surviving on credit-card debt, and not having access to adequate health care or dental care. So I feel very fortunate.

And I ask that you ensure continuation of defined benefits pensions and health coverage for public employees because, as Roy Stone mentioned, this is one way that we can attract qualified and long-term public employees to work for the benefit of the public. Otherwise, there's a lot of disadvantages to working in the public sector, as you know. We could have earned a lot greater salaries working in the private sector -- some of us.

Thank you.

CHAIR PARSKY: Thank you.

Our final speaker, Ian Rudge.

MR. RUDGE: Good morning, Commissioners. My name is Ian Rudge. I live in Irvine, California. And though I work in government, I'm here today speaking as a private citizen.

As you begin your deliberations about potential solutions to the pension challenges in California, here are a few considerations, some concrete, some big-picture. And so I'll start at 30,000 feet.

First, I think it is imperative that you affirm the principle that markets are cyclical. In the world of pension actuaries, there is no such thing as excess earnings. There are only variations from the assumed rate which average out over time. Governments should not use investment earnings in place of the required contributions. Skimming off the peaks only makes the valleys deeper.

Second, the debate between defined benefit and defined contribution is at core a debate over risk burden. For most governments in California, the risk is borne entirely by the employer. With a market downturn, employees living longer but being allowed to retire earlier and retirement multipliers increasing, employers in 2001 and 2002 in California hit the trifecta of risk factors. By scaling back the defined benefit offerings for new employees and replacing some of these benefits with matching defined contribution options, there is a shared-risk solution to be found.

And now two very concrete suggestions: Return retirement ages for public employees to at least the levels they were prior to the market run-up of the late nineteen nineties. People are living longer, period. The average citizen will have to work until 67 to receive full Social Security. I don't think it is unreasonable to ask general government employees to work until 60 and safety employees to work until 55.

Second, while examining the state of pensions in California as a whole can be helpful, there is great variability across systems.

To date, there has been very little comparative analysis of the agencies that contract with CalPERS. CalPERS has that data, and should be making it public in a more user-friendly and up-to-date fashion than simply listing all of the agencies in the State Controller reports with data that is two or three years old. Policymakers need current data to make real-time decisions at the bargaining table.

Thanks.

CHAIR PARSKY: Thank you very much.

I don't think there are any other public speakers that have requested an opportunity to address the Commission.

Okay, that being the case, I just want to kind of set the stage for today. As I mentioned, we're going to hear two presentations this morning, and then we're going to try to focus our efforts on how we're going to go about developing a final report. And I've been working with the staff to try to see if we can't get some structure.

The purpose of this afternoon’s session -- we may start if we have time this morning -- but the purpose of this afternoon is to allow the public and the

Commissioners to take a look at some structure, some concepts that might help define the way in which a final report could be approached, not intending to discuss in depth either of the concepts or some of the issues underneath the concepts, but to agree that in each of our next three hearings we would go about addressing each of the concepts and some of the underlying approaches.

One of our Commission members has also suggested that we take an approach that includes some basic principles. I think it's a good idea, and I think we will try to incorporate that in. And I'll let the author of some of these principles talk a little bit about them because I think he's made some very good suggestions.

But it's -- we'll keep it as a mystery as to which one.

MR. PRINGLE: “He,” you cut out two people.

CHAIR PARSKY: Well, it didn't come from a "her," it came from a "he." But I can assure you that the women on this panel are not bashful, and they will speak up.

However, again, this is meant to kind of set a framework, so that we can address subjects from the commissioners' standpoint. And then staff will be available, and we will have some experts that the staff thinks might be appropriate at each subsequent hearing for the subjects we're going to discuss.

And our whole purpose is to basically say, these are subjects that this Commission really thinks we need to address and make recommendations about. These are subjects which may not be appropriate, but we may want to identify in some way. The whole purpose here is to try to build consensus among the Commission members. So today is really to take a look at what we want to talk about rather than the specific details of what we might say about each of the subjects. And then we'll have three subsequent hearings, and we'll spend the entire hearing trying to identify, trying to talk about each of the categories. And then we'll try to bring things together in the last one or two sessions that we're going to have at the end of November or mid-December.

So with that kind of framework, I think it will become a little clearer as we move in if people are not quite sure, but that's the purpose.

Anne, any thoughts that you might have for this group?

MS. SHEEHAN: No.

CHAIR PARSKY: Any Commission members as we move ahead?

(No audible response)

CHAIR PARSKY: Okay, so let's move to our presentations this morning.

Mike, if you will come forward and introduce yourself to whoever in this august group -- yes, and Mac, too.

MR. GENEST: Can I get water?

CHAIR PARSKY: I don't know, we don't usually allow people that present to have any water of any kind. But for you, we might. It's okay.

MR. GENEST: I'm just getting free things from the government.

CHAIR PARSKY: Well, you can define how much any of that is worth that you get free. That's okay.

Mike, for those that don't know you, please introduce yourself. And I think you've got, along with Mac, an important presentation for us to listen to.

MR. GENEST: Thank you.

Mike Genest, the Director of Finance for the State of California. And I'd like to thank you, Mr. Chairman, Mr. Parsky, and Members of the Commission for all of your effort.

I know has taken a lot of your time and a lot of your expertise, and it will take more. And we really appreciate all this effort. And we plan to heed your advice, certainly look at your findings very carefully.

I have a prepared statement which I've given you. And in the interest of time, I think I'll try to summarize it a bit instead of going over the entire thing. And in particular, a good portion of the beginning of it talks about PERS and STRS, and this Administration's efforts to try to find ways to reduce costs to the State of both of those systems. And we continue to be interested in that because we continue to have a very difficult state budget.

But I think I'll just let that sit with the expectation that we'll get some advice from you. And I know it's not going to be entirely focused, or even perhaps at all focused on reducing the State's costs, but we always have to look for ways to do that.

But with that said, I'd like to go to the discussion about retiree health-care costs -- and see if I can figure out how to work this. Good.

It's our intent in this administration to put something in the January 10 budget that will come out this January, about the unfunded liability.

As you know, we don't actually have to do that. Our report, accounting reports are required to come out for this fiscal year, a year from then. But what our plan was, is to have some sort of a plan, it may be conceptual, it may be broad, it may not be a specific budget action, but some sort of a plan in this year's budget, hopefully informed by the deliberations and findings of this Commission to address -- because we feel that in the long run, with this unfunded liability sitting there, we're not probably going to ever make it go away in the near future. The bond market -- the bond credit rating agencies in particular will be looking at us and other states to come up with some approach. That doesn't necessarily mean that we are required to, quote, deal with it or address it fully this year, but we'd like to have some sort of a start to give them a sense that we are moving forward, we do have the beginnings of a plan.

Of course, that will need to be ratified by the Legislature. And who knows where it will go from there? But we do plan to use the findings and the deliberations of this Committee as we figure out how we want to put that into the State's budget.

For my part, and speaking really just from my perspective, I think the solutions to this unfunded liability problem all fit in this sort of conceptual triangle that -- I don't even know if I have a -- I guess I don't -- that's on the screen, in the sense that I think almost any solution that we or you would come up with would fit somewhere on this triangle.

And as you can see, it's bounded by three extremes. One is to continue pay-as-you-go. The other is to entirely prefund it immediately. And the fourth is to do things with the costs, to reduce the cost.

Looking just at that bottom leg of this table, I'd like to talk first about pay-as-you-go. And I'll come back to the triangle later.

But if we go to the next, you can see that continuing on with pay-as-you-go is really problematic from the State's perspective because over time -- and, by the way, pay-as-you-go, I know you know this, but just for the benefit of the audience -- what it means is simply we pay the cost of the retirees' health care out of current revenues rather than, as we do with PERS, depositing into an investment account and having that pay their costs over time.

So pay-as-you-go becomes a very difficult thing for the State in the near future, starts to rise up as a percent of our total state budget. And we're obviously interested in doing something about that.

But if you look at the other extreme, back to that triangle, of prefunding, that has a lot of -- if we could get there, that has a lot of advantages; and it's tempting for the State to look at prefunding. If we could borrow, it turns out, something like $31 billion, put it in an account, we could get rid of the unfunded actuarial liability, and we would reduce the budgetary costs going forward for the existing employees substantially.

The problem with that is to borrow money -- and this, of course, would involve an expectation that we could achieve some arbitrage, and we would be looking at a taxable bond there which would cost 5, 5½ percent. The actuary uses 7½ percent, or 7.75 percent as the expected rate of return from this fund. But, of course, there's no guarantee of that.

So from my perspective, even though it's tempting budgetarily to go to that borrowing, I think it would be a very risky approach to state finance, and so I don't think we're really looking at that.

I would like to suggest, however, that there might be -- and perhaps you can take a look at this as well -- well, I was going to go to the hybrid, but I forgot to mention, there's the other issue of full funding. And full funding, as you know, simply means that we pay for these actuarial costs in an actuarially sound fashion so that we're paying for the future and the present into a fund. And that is probably the most responsible from a fiscal perspective approach. But just the up-front costs of that are, in light of the State's budget situation, in my opinion, pretty difficult to get to. Because under the actuary's assessment, that would raise our costs from $1.36 billion per year, up to $2.59 billion per year. And I just don't see where we would get that money.

So full funding looks like it might be very hard to get to, in a strict sense, with the existing employees.

But this hybrid that I was talking about falls on that line between pay-as-you-go and prefunding. And it would look something like this.

We don't have an open plan, an open system estimate from the actuary for the State of California, but this is a purely hypothetical one. And as you can see, the pay-as-you-go becomes substantially more expensive than the full funding over time. So one would be attracted to that. The problem is, the unfunded actuarial liability relates entirely to current employees. And this is for an open system, meaning, it would include new employees.

And you really do get some immediate, quick advantage if you're already in that open system. But we aren't there.

So a hybrid approach to get some of this advantage in the future, without having to pay that big-ticket cost up-front for full funding, might be to start full funding for new employees and leave existing employees in a pay-as-you-go mode.

It certainly wouldn't be credited by fiscal purists for that, because what would we be doing about the unfunded liability? We wouldn't actually be doing anything. But, on the other hand, we wouldn't be allowing the addition of new employees over time to make it even worse.

So over a period of time, of course, the unfunded liability is paid off by pay-as-you-go; and we don't have the exact numbers. We're hoping to get them from the actuary in the middle of November or so to try to compare. But it's quite conceivable that something like this could be affordable as an immediate step and be regarded by the rating agencies as a responsible-enough approach to satisfy the need of not having the rating agencies downgrade us.

I want to, however, point out that even with something like that, I don't regard any approach that is entirely on that bottom line, somewhere between pay-as-you-go and prefunding -- that line represents the various financing options. I don't regard any approach that is strictly about financing as being something that's about affordable, especially in the long run.

That's why in this triangle, we put this balanced solution thing in the middle. And we think that some degree of cost control is absolutely essential, at least from our perspective.

Now, "cost control" can mean a lot of things to a lot of people. And if you look at that little white circle in the middle, some people would place it very close to the, "Let's just deal with the financing part, and let's not do anything with cost control." And some people would place it way up high and do as much as possible with the cost control.

So I think that there's a range of options represented there. But to me, and I would hope that you would agree, a balanced solution has to have some degree of cost control in it.

I just wanted to take a moment to talk about what I mean by "cost control" or "cost containment," because I know it's controversial and it raises questions and concerns.

There are, that I know of, three basic approaches to cost control. You can restructure the benefit package, you can do a better job of chronic disease management, or you could do a better job of promoting wellness.

I don't think anybody would dispute those last two points. They're not controversial. They may be technically difficult, and we do need to work on those, and I think we should.

Restructuring the benefit package could range anything from changing the retirement age, to changing what's provided or the part that's provided free of charge to the employee. It could also include more co-pays and that sort of thing.

All of these three types of cost-containment strategies are currently under discussion throughout the United States in the health-care debate. Everybody knows that these are at least some of the areas you can work on. Once you get into the larger health-care arena, there are some other things that people have talked about. But I think we should be looking at these; and I would encourage the Commission to consider that this balanced-solution concept probably makes sense because in the long run, we can't afford simply to finance, in my opinion, the current retiree health-care program -- at least the State of California cannot.

With that, I'll conclude. And I, once again, thank you. And we are looking forward to receiving your findings.

CHAIR PARSKY: Mac, will you want to make comments first, then we will come back?

MR. TAYLOR: No, I'd just as soon do my

presentation, that's all.

CHAIR PARSKY: You have some comments that you'll make, or you're just there -- you're there to support?

MR. TAYLOR: Well, actually, I just assumed you wanted my presentation. I didn't have anything specific to respond to.

CHAIR PARSKY: Okay, go ahead then.

MR. TAYLOR: Mr. Chair, Members, I'm Mac Taylor, Deputy, Legislative Analyst's Office.

Also with me today is my colleague, Jason Dickerson, right over my shoulder here, who presented to you at an earlier hearing, and has promised to bail me out if I get into trouble.

We appreciate very much you inviting us back to chat with you today. And I think the approach that I'd like to take is a little bit along the lines that the Chair was mentioning about what is the framework we should have in approaching this very complicated issue of providing post-retirement benefits?

Let me first begin by just giving you some very basic numbers so we just have kind of the lay of the land. And you can see, these are what we pay on an annual basis for our basic state retiree pension and health programs.

A billion and a half for CalPERS.

Over a billion for CalSTRS.

The state retiree health is our pay-as-you-go cost.

The UC pension, we are currently not paying anything. That has been a super-funded system. That has not had employer or employee contributions. That will be changing in the near future.

And UC retiree health. That, again, is pay-as-you-go cost. Those are not normal costs to the system.

Okay, as far as just a real quick overview of where are we at the state level on the funding of our programs; and you can see, as far as the normal cost and the normal cost as you folks know, but for the benefit of the audience, it's just an actuarial term that approximates the annual costs that you are actually incurring for employee retirement benefits. It's just an approximation, it's an average, but it's a good proxy for the costs that you're accruing in any one year.

And you can see that for our pension, we're in pretty good shape. We're basically funding the normal costs for our state pension programs.

We are not funding the normal cost for our retiree health.

And what that means is, if you move to the next column, that it results in unfunded liabilities. And you can see that we have also those for CalPERS and CalSTRS.

For CalPERS, we at least have a mechanism in place to retire those unfunded liabilities over about a 30-year period.

For CalSTRS, we are making some payments towards our unfunded liability but not enough to really retire over any foreseeable future.

And on the retiree health, we not only have large liability, but those are growing each year because we're not paying the cost of our new benefits as they accrue.

That, in a nutshell, is our state pension and retiree programs.

So I think what you have to first do is determine what are the problems that you want to address. And I suspect that there's not unanimity amongst the Commission as to what the problems are or the priority of those problems. And yet I hope there are some things that can unify and bring some attention to these issues.

I've lumped problems that are commonly kind of noted by people into two general categories.

And the first ones are financial. As we just saw from the other chart, we have very large unfunded liabilities that, in our view, should be addressed.

Just as important, we are still creating new, unfunded liabilities. And we'll have something to say about that in just a second. And this is primarily in the retiree health area.

Some folks have mentioned the volatility of employer payments as being a problem.

Now, with CalPERS, they've taken actions to change the way that they handle their assets and to smooth that out, to where I don't think that's going to be a huge problem for the CalPERS system in the future. It may still be a problem for other systems.

And finally, I think you had one of your public testifiers noted that it's the employers who assume virtually all of the risk for retirement benefits, both retiree and pension. That is, at the margin, any additional costs are borne by the employers. By the same token, if costs go down, they are the ones that are the beneficiaries of that.

There are also problems, though, of benefit design. And I think in some ways, these are just as important, because I think it's tended to be viewed as just a financial problem, and I don't think that's true. I think we have a situation where our retirement programs may not be meeting all of our employee needs. And I think this is very important to consider, not just the employee groups you hear from; it's employees that don't stay in state service, who leave state service, who never join state service, because our retirement programs may not be meeting their needs. And I think you need to keep that in mind also.

Our programs may not be meeting our employer needs, and again for various reasons. Maybe they're volatile or assume too much risk. There are certain problems that result.

When we granted final year comp several years ago, I don't think the problem was so much that, well, this was a more generous benefit; the problem was that it caused a pension spike. That's a design problem, not necessarily one of the benefits are too generous. And I think oftentimes we don't delineate between those two different types of problems. And it helps generate perhaps more emotion and unnecessary heat than is needed in this discussion.

Finally, I think in benefit design, there's the nature of employee commitment. That is, in the past we have just said, "When you're a state employee, you will get these health benefits. And because we have not reserved the right to make changes in those for future, for future employees, for future service, we've kind of been, in effect, stuck or locked in on that benefit plan for the whole life of that employee and the life of their survivors.

That doesn't have to be the case. It's not the case right now for UC retiree health. And it may be that the employers need to preserve some more flexibility on future service of future employees.

I want to just briefly touch on some basic considerations that sometimes I don't think get enough attention about, again, context for you making your decisions about these retirement programs.

And the first one is total compensation. Retirement, as you folks know, is just a form of income that we grant to our employees. We either give current income or we give deferred income. And in that ideal world, employers would really not care about the mix of current income versus deferred income. That would be a choice that employees would make. In fact, we would probably want to encourage people to have deferred income. We used to view that as a virtue for people to save money.

Somehow now it's turned into, well, if your retirement benefits are -- they're too generous, that's somehow turned into a vice. And that's why we don't particularly agree with that approach; and that's why you'll notice, in the problem definition, we did not include a problem that retirement benefits are too generous. They may not be designed right, they may not be the right mix for all of your employees. But to say they're simply too generous has no meaning to us.

If you want to say that total compensation is too generous, that we're providing for some of our classifications too much total income that we need to, that there's plenty of people who go work for us at some lesser compensation, we can say that's a problem. But simply to say that retirement benefits are too generous I'm not sure is real helpful to the debate.

Personnel considerations. The State is currently undergoing a kind of top-to-bottom review of the way that we recruit, hire, promote, classify employees. And I think it's long overdue.

And really, retirement programs since compensation and salary are just another piece of what the State needs to consider.

So I think it's appropriate that at the same time we're doing that on that side, that you're looking at these retirement benefits, to make sure that they're up to date, that they're modern, that they're meeting the needs of both employees and employers. But it's just a piece. It's not something that you can look at all by itself and say, "Gee, that's not a good retirement program," or "That's too much," or "That's above the national average." It really has to be put in our view in this larger context of both your compensation and personnel needs.

One other basic consideration that you have for a couple of your programs are governance issues. And I think CalSTRS is probably the best issue of this. It's not just a question of the State saying, "Well, here's what we want to do." You're dealing with local school districts, you have different levels of government involved, and it's much, much messier, I think, when it comes to CalSTRS, as I'll go into just a little more in a minute.

All right, so having said that and given you some context, what is it that we would recommend that we could really firmly recommend you do? And I think we would say that the only thing we can unequivocally tell you that we would recommend, and we have recommended to the Legislature, is that you need to pay for benefits as they accrue. If public employers had followed this one rule, we would not be sitting here today. It's a very simple thing and it's very difficult to do. But we would no sooner not pay our employees their salaries monthly, and we should view the payments that we make for promised retirement benefits in exactly the same way. So what that suggests is that, to us, if you're going to follow this, what do you need to do right now? If you're going to continue to grant health retiree benefits on their same level, we need to start paying for the normal cost, and that's almost $800 million a year.

Maybe you can't get there all in a year or two or three, but it seems to me you can be very strong in saying, "This is what you should do." There may be some action needed on CalSTRS and UC, but we'll just leave that for now.

A related, I think, corollary to the principle of paying for benefits as they accrue, is that you don't grant retroactive benefits. I think we've gotten into trouble by doing this in the past. It's easy to do when those returns are very high. But as an earlier testifier said, you can't get them back during the bad times. So I think this is something we can feel pretty strongly in telling you that it should guide your deliberations.

Addressing unfunded liabilities I think is a little bit harder. And the reason for this is those liabilities have accrued over many decades.

And I think just from kind of an intergenerational perspective, it's not clear who should pay for those kind of past sins. Although I think we have made a pretty good case, and I think one can make a pretty good case that current taxpayers, all of us, didn't pay for the costs that we should have in recent years. We should probably be paying for some of those. And I think you can make a pretty good case that we should have a plan for paying off these unfunded liabilities, just as we do for CalPERS, for all of our system, and to try to do it over a reasonable length of time. Actuaries love 30 years. Nothing magical about it. But I think what you guys could do is try to force that issue of having a very definitive plan for paying those off.

We're not going to start on this year or next year at the State level. We don't have the money. But we don't mean we can't be planning for the future when things finally turn around and we get our budget in order.

So the fiscal implications of that, as you can see, the dollars are enormous. And that's why you're not going to see it happen in the near future. It doesn't mean, though, you can't get that on the agenda, get it out to the public, make it very visible. This is something we should do.

Let me kind of move along here. Pension benefit designs. Again, it's not just a financial problem, though. I think for us the question is, what kinds of retirement benefits will attract and retain our employees? Just a note, there's a very large percentage of State employees who never vest, they never reach five years. There are a lot of employees that never join the State because they may not value our retirement benefits.

So it may be that our current approach of providing only for a defined benefit plan may be too inflexible. It may not be serving our needs as employers, and just as important, it may not be serving all of our employee needs.

Well, what might you consider? Again, this is not a recommendation. This is not the right answer. I don't think there are right answers here. But one thing you might consider is, what if the State provided -- let's take the current amount of the normal cost contribution that we're making for retirees, it's about 11 percent of salary. What if the State said, “Look, we'll grant that 11 percent to you employees, and you can do with it what you want. If you would like to maintain yourself in the current PERS program with the defined benefit plan, you can do that. If you'd like to take that over a defined contribution plan because you're not sure you're going to be with the state very long and you want to have the portability, maybe we should do that.

You could have a hybrid of a smaller defined benefit plan and the rest in a defined contribution.”

There are a lot of things we can do. Again, what should drive us, it seems to me, is what meets the needs of a broad spectrum of employees, including those that may not be working for the State right now.

I think you have similar concerns on retiree health benefit design. There are even more employees who never have any benefit whatsoever for health benefits, that is because they may leave the state before they hit 50, they never get ten years. And so that's of no value to them.

There's also, of course, the problem that the State has this large uncertainty on the health cost. Much more so than with pensions. There are just so many variables that the State and local governments are really bearing enormous risk, I think, if they continue to grant the current health benefits.

We don't have great solutions for you. So what you should do -- Mike had suggested some things on retiree, your speaker suggested some things. I think what you want to do, though, is avoid the situation that you're now seeing with some counties of saying, "We're not going to offer any benefits to our retirees." I don't think that's in the interest of your employees. We know that's not in the interest of our employees. I don't think that's in the interest of the employers.

What do you need to do then to make sure that employees have some assistance in providing for the backfill of this kind of Medi-Gap coverage? Well, again, there's other things, that especially with more creative federal tax policy, we may be able to use defined contribution-type plans or cost-sharing, access to the state pool for those who don't quite vest. There may be a whole array of things that we can do that helps, again, the State control its risk, employees to have options.

One other thing that, again, we've recommended that for all future employees the State, again, preserve more flexibility, that is, the right to make some adjustments in future years. I know that could be a little more controversial, but we think that's important in the same way if you think of retirement as total compensation, you can adjust salaries and other things, it seems to me you should have some ability to adjust future service and future benefits.

Again, real quickly, on CalSTRS, you have the State involvement in local compensation issues. Districts determine most compensation issues, local school districts determine most compensation issues. Retirement issues are typically done at the state level.

It's not a very healthy situation.

If you believe in total compensation, it seems to me that should be done at the local level.

There's a large unfunded liability that needs to be addressed also.

So I think when you think about STRS, it's really a little bit of a different ball game. What we've recommended to the Legislature is you first should clarify the state-local rules.

And I think what we have suggested is, in keeping with what is the rule for everything else, that local governments should be responsible for determining those retirement benefits in negotiations with their local employees. That doesn't mean you can't have STRS, that doesn't mean you can't have statewide plans that help with portability; but it means that locals would be responsible, both employees and employers, for the cost of any plans that they did. The state would no longer be on the hook for any future service.

As far as the unfunded liability, if you address those other problems, it seems to me the State probably is going to be responsible for a large chunk, if not all of the existing unfunded liability. That may be appropriate.

Again, just a quick note on UC. They have more constitutional authority, and they're going to need to start making contributions for their pension and retiree. And I think the State Legislature's avenue of access into that is with our funding. And I think the Legislature can influence the way that's done. But what we want to make sure is you have a fully funded system. Let's don't blow it. Let's make sure we make those normal cost payments to maintain that funding status.

Whoops, I went too far.

I think, in conclusion, there are certain principles, again, paying for benefits as they accrue. But generally speaking, I think -- whoops, I don't know what I've set off now. Okay.

What I think the Commission can do is hopefully reduce the heat and increase the light on the issue. And I really do think that despite the makeup of the Commission and the different beliefs, I think there are some basic principles that you can agree on, that can really help and bring some clarity with the issue.

And with that, I thank you, Mr. Chairman.

CHAIR PARSKY: Thank you very much.

I think both of these presentations were excellent, and are exactly the right kind of framework for us as we move into trying to structure a series of recommendations.

We're going to let everyone kind of get in some questions.

Let me just start by, Mike, do you have any kind of comments about some of the comments that were just made at all, or should we just get into some of the questions?

MR. GENEST: Well, I would like to second what Mac was saying about the focus on total compensation as an employer, and we have begun to do that at the state level.

Ideally, your total compensation would be purely market-driven. At least that would be my ideal. You can't really do that in state government. But we have the ability to compare our total compensation to that of other governmental entities and the private sector. And we have generally found that State compensation, when you look at the total compensation, is below especially local government. It's substantially below local government in many categories. And I think that it is appropriate to look at total compensation and not just look at the retirement piece or the retiree health-care piece.

On the other hand, every year in the budget we have to budget the money. And sometimes the budgetary constraint becomes more important than the perfect compensation strategy desire. So that's probably the kind of budget we're headed for in the next few years. Certainly next year is going to be tough.

CHAIR PARSKY: I guess one basic question I have which may cut across what both of you are saying, isn't it inherent in not letting the status quo just sit, is establishing for our elected officials the need for maybe rethinking priorities, because it's a matter of choice. If they really believe that leaving this situation, namely, a situation in which inherent in this system is saddling future generations with this problem is not acceptable. Therefore, they have to start a program of establishing the priority of dealing with this unfunded liability in some way at the top of the list as they make choices.

Unfortunately, for officials, at times problems that may be identified as occurring in the future, are put off until the future. And it seems to me, both of you are suggesting, and we would certainly welcome a combination of the legislative leadership and the Governor coming forward and establishing this need as a current priority.

Isn't that inherent in what both of you are saying?

MR. GENEST: I think it is. It's also, I

think, the Governor's hope in creating this Commission, is to get to that point, where elected officials can recognize the need to be responsible and have some longer-term thinking.

And you're right, it's very difficult to think long-term, especially when you're dealing with this year's budget or this year's set of policy priorities.

CHAIR PARSKY: But inherent in that is perhaps putting down the list some priorities -- current priorities that may be appealing, but may not be able -- you can't -- I think you said and maybe Mac said too -- you cannot deal with everything. You can't make, quote, “everyone happy” in the current budgeting process. So you have to determine your priorities. And if there's anything, I think, that this Commission can do -- there was a reference to shining a light on this -- if the legislative leadership and the Governor are serious -- which I believe they are -- then hopefully coming out of this Commission and its recommendations will be a commitment to move this up to the top of the list in terms of how they're going to deal with this on a current basis.

The second question I had was also inherent, I guess, in both of your presentations is this notion that we've got -- one basic principle -- and I can disclose that Matt Barger was the commissioner that put forward a number of principles that we need to be considering. But one of the principles that he would like us to consider and work in is this notion of moving away from the notion of just covering current obligations and dealing with future obligations so it's not on the backs of future generations.

Is that not inherent in what you're saying you think we should do? Both.

MR. TAYLOR: Absolutely.

MR. GENEST: *(Nodding head.)*

CHAIR PARSKY: Then it seems to me that we can discuss that as a basic principle and what it means from the standpoint of priorities in terms of major policies.

Matt, do you want to follow on that kind of concept?

MR. BARGER: Sure. I mean, when I sit and talk to my children and tell them what it is that I'm doing, gallivanting around the state, going to these various hearings, you know, my basic principle is that I want to make sure that our generation pays for the services it's getting; that we don't run up the bill and then turn around and hand it to the next generation.

And you can see why it's always easy, in any given year, to sort of default to the sort of pay-as-you-go, because every year there's problems in making the budget work. And yet if that's always the case, you never get to deal with the long term.

And I think the chairman said this is really about priorities and, you know, sort of what are the principles -- what is important when you're doing the budgeting.

And I think one of our jobs, I think, is to raise the priority of that. That we have a responsibility to be fiscally correct, to do the right thing.

And it's interesting, I think my teenagers get it right away. It's basically teenage finance, which is, they always want to spend their allowance right now on whatever it is, and then the weekend comes and they don't have money to go to a movie. And it's like, yeah, that's it, there's no such thing as a free lunch. You can't have both.

CHAIR PARSKY: Before we turn it over, I would like each Commissioner to kind of ask whatever questions they would like.

The other thing I just wanted to come back on is this notion of looking at total compensation and not focusing so heavily on whether benefits are too generous or not too generous.

And I think inherent, Mac, in your comments, which I thought were quite good, is this notion that you can't really look at how to deal with benefits for future employees in a vacuum -- or current employees in a vacuum, that you have to look at the benefits.

Certainly those of us that had been actively involved with UC really understand the importance of seeing how a compensation scale that doesn't compete with institutions that are seeking the same employees is, quote, “made up for it in some way, or dealt with in some way” by the benefits that are created.

And I think I'm hearing -- you correct me if I'm wrong -- I'm hearing that you're really recommending to us that we not, as maybe some people that have tried to approach this, just look at the benefits side of things, but look at this as a total compensation issue.

MR. TAYLOR: I think the UC is an excellent example. For years, both universities have claimed that their salaries are below their comparable institutions. And we've always asked them, "Well, what about your benefits? How is total compensation?" Well, UC did a study, and it turns out that if you take into account all the benefits, their compensation is pretty comparable.

CHAIR PARSKY: Right.

MR. TAYLOR: So then do you know what their response was? "Well, our members don't value those retirement benefits as much."

That's a pretty interesting comment. It either suggests that we shouldn't be offering those benefits if they don't value them, that UC professors are irrational and have too high a discount rate and should save more; or that they're very rational people and that they know that they may not be at UC eight years from now. They may have changed institutions, and they wouldn't get much value from those current retirement structures. You could say any of those things. But it is a very interesting situation.

But I think you have to start with the total compensation. And if they don't value those, okay, we'll increase your salary, but we need to do something else but we don't want to overpay.

CHAIR PARSKY: Well, and coupled with that is the fact that UC has a unique situation, and I think you've pointed it out, and that is that we created, if you will, a contribution holiday. And we've heard testimony about the problems that that -- inherent in the problems that that's created.

And your comments, I think, I hope the legislative leadership and the Governor heard because, in part, a willingness to begin contributions again depends on the availability of funding from the employer as well as the employee.

And so we'll repeat your urging, because you can't have it just one way.

MR. TAYLOR: Exactly.

CHAIR PARSKY: John, why don't you start us off?

MR. COGAN: Let me first say, for both you guys, thanks very much for your years of service to the State. Both of you guys have been in the government for a long time and have done the State a real service.

Mike, let me start with you. Following up on what Gerry and Matt were saying, I'm a little bit, I guess, confused by what I read in your testimony. I wanted you to clarify something for me.

On page 4, you say that, "The State has little or no capacity to absorb significant increases in outlays next year, such as converting to a full-funding approach for retiree health care."

So you're making it sound like it's a scientific or a fact-based statement. In reality, it's either a political judgment, or it's your assessment of reality as you think of our State Legislature and where they are.

And I just wanted you to clarify which one of those it is.

MR. GENEST: I think it's probably both of those. Plus, just the math of the budget. If we look at our budget right now, as we projected into next year, we've published a figure that says we're going to have to reduce General-Fund spending by $6.1 billion.

Since we developed the revenue estimates that support that, we think we've lost something, and probably a couple of billion is a reasonable number with the way the economy is behaving and the way our cash has come in.

So if we're going to cut 8 percent of what state government does -- and I would say that's a reasonably good estimate of what would be the long-term structural deficit that the State really has. No one really knows what that is. But 8 percent is about right. And you can translate that into something else. You can say, we are roughly 8 percent oversubscribed. The State government is already trying to do substantially more than it has the long-term capacity to continue doing.

Retiree health care, pension contributions, debt service, the UC system, our health and welfare system, Proposition 98, all of those things, they add up to that amount that we've agreed to take care of that's beyond our resources to do.

So looking at that kind of a budget makes me believe that the chances of not only cutting $8 billion, but also cutting another billion or so in order to afford to go with total full funding for all current and future employees for retiree health care, for example, is probably politically unrealistic and almost arithmetically unachievable.

MR. COGAN: Nonetheless, it is a value judgment in part that you're making. And I would agree with Gerry, look, the reason that we're in this problem that we're in with pensions and with health-care benefits is because our political system continues to make the same judgment, preferring current benefits over funding promised benefits for retirees. But what we're up here about is trying to change that kind of political judgment and getting the political system to think differently about future liabilities than they currently do.

Now, on your hybrid proposal, it seems like we're going down the same road again. As I understand it, under your hybrid proposal, we wouldn't reduce the unfunded liability that we currently have for current workers. We would do something about increasing the unfunded liability as a consequence of hiring new employees.

The fact is, we could leave the unfunded liability that the State has now untouched. In fact, as employees accrue more time on the job, those liabilities would grow.

It seems to me that if the Governor, after setting up this Commission, having us go around the state, assess the liabilities that the state is responsible for, would then come up in his budget and propose to the people of California that the Legislature do nothing about those liabilities, to me, that's a huge mistake. To me, that would be a failure of leadership.

And so I'd ask you to rethink that recommendation when you go to the Governor, and tell him, regardless of the politics, to stand up and begin putting dollars behind the promises that have been made to California's workers.

And as far as the fiscal impossibility of this goes, as near as I can tell from your numbers, the impact of full funding is about 2 percent of the budget, maybe less than 2 percent. If you can't find 2 percent in the budget to cut out to finance these benefits, then we should get a whole new group of people in Sacramento.

Now, I don’t remember the question I was going to ask --

MR. GENEST: Let me, without wanting to respond to you --

CHAIR PARSKY: Well, I'm glad we're moving toward that soapbox. We're not quite there yet, but that's okay.

MR. GENEST: I'd rather not respond to every single point that Mr. Cogan makes. But I do want to clarify something. That's not a recommendation. It's something that I have thought would be sort of what you might think of as a "tweener," in a very tough spot, where you're looking for a tweener. I don't know if it actually works. We have the actuary looking at some numbers for us to flesh that out.

I throw it out there as something to think about, obviously. It's not something that you like.

MR. COGAN: Tweeners are for legislative bodies, not for commissions nor governors.

Let me ask Mac a question.

Can you maybe elaborate a little bit on the idea of sorting out the STRS program in terms of part of it being state responsibility, part of it being local responsibilities, and how you could envision some kind of plan for sorting it out?

MR. TAYLOR: Sure. And I mentioned a few things. But I think first and foremost, we would have the responsibilities at the local level for determining total compensation, all aspects of that. So retirement. And local districts for all future employees at some point in time, they would bear the normal costs for the system. Because what's happening right now, in effect, is we're not quite paying the full normal cost of STRS benefits. So not only is there unfunded liability, there's probably a state responsibility. As they say, “When you’re in a hole, stop digging.” Well, we're still digging and the hole is getting bigger.

And I just think, from a governance perspective, you could go another way. You could say the State is going to determine all school district compensation, and we'll have a statewide salary. So there is another way to go. It’s just that’s not what the Legislature and the State have set up. We have local governing boards to determine those things. We think they should determine retirement. And, again, that could be done similar to the way that CalPERS provides a lot of benefits to local governments. It's purely a service provider. It tells you what the costs are, they pay it, and it has different plans. You could have a variety of established plans. You could let locals be on their own. There's a whole panoply of options available.

But I think for us, it's saying that, "Locals, it's your ball game. You're responsible." And at that point, they know, I think, the State could come in and say, "We now have a plan for retiring this old problem, this old unfunded liability."

CHAIR PARSKY: Before we move on, just one follow-on question, Mike.

You seem to suggest that addressing the financing needs, if you move to a prefunded approach would severely impact the creditworthiness of the State, or could impact the credit worthiness of the State if you borrowed the money necessary to prefund.

Was that one point you made?

MR. GENEST: I wasn't saying that. I think my point about the creditworthiness, or the credit rating of the State, is that, if we don't do anything, that's in jeopardy. And it may not be instant, but it will be fairly soon that we start slipping. Our credit rating, official credit rating, is already pretty low, although we sell our bonds at essentially an AAA rate.

CHAIR PARSKY: Right.

MR. GENEST: So we have to address it in some way. I don't think we have to address it in any particular way, just in some way.

CHAIR PARSKY: But I guess my point is, if the credit agencies view what we are talking about prefunding as a liability, whether that liability just sits on the book or whether you borrow to deal with a portion of it, it shouldn't make any difference.

MR. GENEST: No. And that wasn't the point I was making. I'm saying that the borrowing strategy, it's tempting because it would take a large number out of the budget, and it would immediately wipe out the unfunded liability.

On the other hand, it's based on the assumption of our ability to get arbitraged. It's based on the assumption that we can earn more than the rate that we'll pay to borrow the money. And that's probably a great kind of assumption for private businesses to work with. But I think for the State to engage in that is too risky.

CHAIR PARSKY: I was just looking at it, not so much from the arbitrage, but from the standpoint of how the credit agencies would view California.

Now, I'm not saying this is a direction you should go, and I was just curious about your issue of how you find the money necessary to prefund.

MR. GENEST: Well, there are so many variables.

CHAIR PARSKY: And I know Mr. Cogan at that end of the table has already given his point of view about where you could find the money.

I just want to make sure we understand what impact other approaches might have.

MR. COGAN: Now, Gerry, the unfunded liability of health benefits, though, are uncertain; right?

CHAIR PARSKY: That's true.

MR. COGAN: It's not clear how legally obligated the State is to future health-care benefits.

CHAIR PARSKY: But how did the rating agencies view that unfunded liability potential?

MR. GENEST: Well, we're going to report it. And I don't think we're going to discount it in the sense of saying, "Well, we don't really owe all of this." That, I don't think, would be kosher, and I don't think it's correct. I think we believe we owe it all, that we will be paying that.

You saw that ARC going up in the future. Now, there are ways to make it cost less, and that's -- we don't owe a particular amount. If we change something about the benefit package, we can make that cost go down in the future. Although that's not going to be too easy compared to the actuary report because, as you remember, they have a 4½ percent medical inflation rate built in, and that is a pretty ambitious goal. That's not something we've seen in recent memory.

I think it could be achieved, but you'll need aggressive action on the part of the State to drive down the costs of health care if we're going to really stay at that. And then to take it down even further I think is possible through some of the mechanisms that I talked about. Very politically difficult, but possible.

But whatever that liability is, to borrow money for it, number one, we would certainly have to get a vote of the people to do that. Number two, our total outstanding debt would go up dramatically, and so our debt ratio that people look at would be pretty high if we did that.

It might make sense just on the arithmetic, but I think there are some concerns about the approach that make it one --

CHAIR PARSKY: Well, I guess the question is, without addressing the issue of the magnitude, I think that most of the people here view it as debt, anyway. And so I don’t think you necessarily deal with the issue of whether people would view it as debt or not debt.

The issue of the magnitude of it, I think, is appropriate.

Okay, Bob -- we'll go straight around the table.

MR. GENEST: Can I say, we just lost a court case on an issue very similar to this. We had a pension obligation bond. The court ruled that it violated the State's debt limit. We argued in that, that the things that we're being paid for were already a debt to the State and, therefore, we were creating no new debt. You can make that same argument here, but we just lost a case on that point.

Now, I'm not a lawyer, so maybe there's a distinction here between this instance and that. But it doesn't look hopeful.

CHAIR PARSKY: Bob?

MR. WALTON: Thanks.

Mac, Michael, thank you very much for being here today. I really was interested in your testimony.

I just had one clarification for Mac, if you would. I was intrigued by your possible approaches for STRS and dealing with it at the local level for retirement. They do that now for health but not for retirement. It's a statewide plan.

Can I assume that you would apply the same logic for classified members that's under PERS, that currently they're under one statewide plan and that you should treat them the same?

MR. TAYLOR: That would seem logical.

MR. WALTON: Okay, that's it.

MR. COTTINGHAM: Good morning. In looking at -- this is for Mr. Genest.

One thing that I was looking at when you talked about SB 1105, where the Governor did create a hybrid plan where new state employees can go into a DC and then convert later to CalPERS, deposit that money and the state makes up the difference. I mean, hasn't that, in a sense, created a different kind of unfunded liability for the State, unless you have prefunded for the money? Because these people are not going to have enough in their DC account to cover that two years of unpaid-for retirement benefit.

MR. GENEST: When that program was being adopted, we had some very rough estimates, and they relied on assumptions about how many of these new employees walk away versus how many stay, and how old will they be and so forth. And we did not have an actuary, nor did we have any actual experience with it. So I think everyone involved agreed that the numbers that we had at the time were a little bit speculative, kind of the best guess we could do. But those numbers showed that it would save money, both in the contribution and in the long run, in the system.

Now, has that panned out? We don't know yet. As I said in my written testimony, it's really too early for us to have the kind of data that we would need to evaluate whether that was actually a money-saving move or the opposite, and we just don't know. But the initial estimates showed that it would save money.

MR. COTTINGHAM: Okay, when you talk about the reporting and the effect on the credit rating, I mean, that comes back to GASB. We've had presentations from Standard & Poors and the GASB board. And one of the things -- you looked at a plan for totally paying by doing a bond and covering 31-point-something billion, to totally eliminate the unfunded liability. But GASB doesn't require that. Our understanding – or my understanding is that they require a plan, a viable plan, so that you could -- even if you did your hybrid, where you propose the plan and new employees are -- you start covering their ARC, you could still do prefunding on the current employees and still lower that liability. I mean, eventually that liability is going to go away as the years go on, but you could still cover that plan.

And as Mr. Cogan pointed out, we're not talking on a yearly basis, I mean, a huge amount. I think the disservice that is done is that the only number people ever talk about is what GASB looks at as they want a 30-year projection.

MR. GENEST: I don't think anybody knows what the standard is going to be. One will undoubtedly emerge after several years. And by "standard," I mean, at some point we'll probably know what constitutes an acceptable plan from the market's point of view and what constitutes a reckless or unacceptable plan. I don't think anybody can say right now what that standard is. Any number of things might work.

There are some states with no unfunded liability or that have already taken steps to eliminate them because they were so small. And it may well be that let's say 49 other states find a way to completely eliminate their unfunded liability in five years, and California still labors with one, I think that would be detrimental to our credit rating. But we don't really know how that's going to play out.

I think what we want in our January budget when we make a proposal, is to make one that we think -- hopefully that you would all recommend that would be responsive to GASB 45.

And what does that mean? I don't think we actually know what it means. We'll have to use a little judgment.

MR. COTTINGHAM: When we talked about some people vest -- or no, I'm sorry, you talked about that a lot of people never vest in the system; they leave. And, actually, that's a return to the system.

MR. TAYLOR: Affirmative.

MR. COTTINGHAM: I was going to use the term "windfall," but that's not exactly correct. But it's money that they come in with that they don't have a liability of going out on.

But, on the other end, when we talk about raising retirement ages, I know from dealing with other legislative issues, that we have employees that stay beyond their maximum benefit period and there are still contributions being made.

Is that something that also gets calculated into the system as helping the funding level of the system? Does that -- I guess it's not prefunding, but you have money coming in that is not earmarked for somebody else.

MR. TAYLOR: Well, Mr. Walton probably knows this better than anybody, having served on PERS and worked with PERS as long as he has.

But, yes, all of that goes into the system as part of your actuarial calculations, that we do get the benefit of people who leave. The contributions made by employers goes into the pool, and that's all part of the actuarial calculations.

Someone who works past, what is it, 63 now? I think we max out on our 2.5 for a miscellaneous member. You're still earning years of service; but, I don't know, maybe those contributions are not commensurate with the costs. But I think those are relatively small issues.

MR. COTTINGHAM: Mr. Genest, you talked about in the ongoing OPEB, which is part of the focus -- the real focus of this group, that your projections are that there only be a 4½ percent inflation rate?

MR. GENEST: That's not my projections. That's what the actuary used.

MR. COTTINGHAM: A projection has been made.

Is there something that, from your office or from the Governor's office, that can be done, will be recommended to help control those?

It seems like the one place that we could -- we're controlling pensions, and we can deal with that. We have the actuarials. We've been prefunding for decades. We haven't prefunded for health care. And the one area that we had the most limited control over is health care.

Are there recommendations on how we can come back and control the health-care industry?

MR. GENEST: Well, the entire health-care industry? No.

CHAIR PARSKY: Give him five minutes.

MR. GENEST: We don't directly control the package of benefits, at least not in every detail. PERS has a lot to say about that. The Legislature has a lot to say about that.

We do have a lot to say about how much the

State will pay, but that tends to be a bargained issue also.

So there are a lot of players, a lot of parties at the table. If we put something out there about cost control and health care, it would be more our hope or guidance to all those other parties as to where we think this should go.

I would only say that I think it's inevitable that we have to do something.

I personally am a skeptic, that if we just sit and let things happen as they have, that we're automatically going to run up against some limit.

The basis for the actuary’s 4.5 percent is the assumption that at some point, health care can't take any larger share of the state's -- of the country's GDP. Well, I remember when I was first doing some health-care work back in the early eighties, it was around 7. And it's about 17 now.

Is 17 some sort of a natural limit? We're in the physics building. Maybe there is a formula. I don't know. But I don't see why it couldn't be 30 percent or it could be 50 percent.

So we can't just assume we're going to get that 4½. I think all of us -- that includes PERS, that includes the employee unions and the administration and the Legislature -- are going to have to do strong things, affirmative things, not only to get to 4½, but I would argue, we probably should try to do better than that.

MR. COTTINGHAM: Thank you.

MR. LIPPS: This is for Mr. Genest. And I did go to a small liberal arts college, so the only thing I ever learned was the Socratic method.

I just have a series of questions about some of your charts, if I could. They're just clarification questions.

Chart Number 1 -- and I don't even recall seeing you flash that up there. I don't know if it would be helpful for you to flash that up, but it's a contribution for retirees.

MR. GENEST: Right. It has STRS in the green. That's the State's contribution for STRS in the green. Our PERS contributions are in the red, and yellow is our retiree health-care costs.

MR. LIPPS: And the retiree health, is that also through PERS?

MR. GENEST: Yes. Well, PERS does the benefit package --

MR. LIPPS: Got it.

MR. GENEST: -- that comes out of the State's General Fund.

MR. LIPPS: Thank you.

So the dollar amounts on the left vertical line, those are meant to be in the millions, not in the thousands of millions?

MR. GENEST: I'm sorry about the labeling. Those are billions. It's one billion, the number there.

It's in the thousands, so it's one billion.

MR. LIPPS: All right, so those are in thousands?

MR. GENEST: Yes.

MR. LIPPS: So it's about a $5.5 billion projection for the State contribution for STRS, PERS, and retiree health for 2007-2008.

There seems to be a big jump up in the STRS portion.

Do you know what that's attributed to?

MR. GENEST: That's because of a lawsuit that we lost.

If you go back to 2003-04, do you see how small the STRS bar is? It's abnormally small, and that's because we withheld a $500 million payment at that time.

Then fast-forward to 2007-08, it looks larger than it should be, and that's because we made that $500 million payment just this month.

MR. LIPPS: So relative then for the STRS portion alone, then if I just sort of do the mental math, really it's fairly consistent with what it was in 2000-2001, 2001-2002 as a percentage?

MR. GENEST: Yes.

MR. LIPPS: If I could refer you to Chart Number 3, the “Pay-As-You-Go as a Percent of General-Fund Revenues.”

And this is for retiree health; is that correct?

MR. GENEST: Yes.

MR. LIPPS: Okay. And what I'm getting from this chart, is that between the current year, 2008-2009 -- and I'm just right now looking at 2018-2019 -- although that looks like a fairly dramatic increase in the line, what we're talking about here, do I do the math correctly, that we're talking about an increase of 1 percent?

MR. GENEST: Well, that's 1 percentage point of the State's General Fund revenue, which itself is growing in that period.

MR. LIPPS: Right, I understand that. But as a percentage of expenditure, we're talking about a shift of 1 percent if we stay with the pay-as-you-go over the course of the next ten years? And I'm looking just at 2018-19.

MR. GENEST: Yes. Just trying to see it up there, it looks like it's about 1 percentage point, yes.

MR. LIPPS: Okay, then it tends to flatten out. Is that based on some of those actuarial assumptions that you're using from other agencies?

MR. GENEST: Well, it's based on one actuarial assumption: People don't live forever. And as they stop living, we stop paying.

MR. LIPPS: But aren't we still adding people to that --

MR. GENEST: No, not at all. This is only current employees.

MR. LIPPS: Only current employees? Ah, got it. Thank you. And that is a good clarification.

MR. GENEST: I don't think the actuary accounts for when they win the lottery and move to Tahiti, and there's probably a few of them that will do that, but not many.

MR. LIPPS: And finally, Chart Number 4, if I might. And we're looking at the full funding versus pay-go in a hypothetical open group.

MR. GENEST: Right. And, actually, it's not hypothetical. It's picked from some other jurisdiction, we don't know which one. The actuary just said, "This is how it looks." This is a fairly good depiction of how that relationship works.

MR. LIPPS: Oh, so this is not based on the State budget?

MR. GENEST: No, it’s not. It has nothing to do with California, other than we're trying to see if we were to move to full funding, how would that relate to the costs of pay-as-you-go? Well, we don't actually have that data from the actuary. We're trying to get it. We should have it in mid-November. But this is how that relationship works in some other jurisdiction that they think is sort of typical. The numbers from California's perspective are meaningless. It's the shapes that we're looking at here.

MR. LIPPS: So if I'm just doing the mental math kind of correctly, some 30 years from now -- 35, 36 -- the difference from where we are now in terms of pay-as-you-go funding to full funding compared is about a 40 percent increase in terms of the cost?

MR. GENEST: It's a little higher than that to me, but in that range.

MR. LIPPS: So from about 1.2 billion for this hypothetical entity to nearly 1.6 billion. So it’s about $400 million, 25 --

MR. GENEST: Actually, it's probably a little lower than 40.

MR. LIPPS: Yes, it is lower than 40 percent. Well, no --

MR. GENEST: I think the point that we're taking from this is if you look all the way to the left, it's slightly -- now, in California, with our actual data, the number would be much larger than that because we have such a large unfunded liability.

But here, it's only slightly less expensive to do pay-as-you-go in the short run; but in the long run, it becomes dramatically less expensive.

MR. LIPPS: Well, actually, I hadn't quite gotten to my point. Because my question would be, on the revenue side of this, what would be the increase in the revenues? Over -- in this hypothetical entity, over the course of 30 years, compared to this, roughly, let's say, 40 percent increase in the cost?

Because as a percentage of the -- I guess what I'm trying to get to is, as a percentage of expenditure, some 30 years out or 15 years out -- you know, pick a point in time --

MR. GENEST: I don't know that those –- I don’t know how the actuary dealt with the revenues of this entity over time. I'm assuming, just because there's not very much growth there, really, for that amount of time, that these are probably inflation-adjusted numbers.

MR. LIPPS: Oh, so you think that these may be constant dollars?

MR. GENEST: I believe they are, but I don't actually –- and Tim here doesn't know off the top of his head. We can find out from you. But they look like they would almost have to be.

MR. LIPPS: Thank you very much.

MR. PRINGLE: Yes. Thank you, Mr. Chairman. I'll make it brief. A couple of things.

First, off, thank you, Mr. Taylor and Mr. Genest.

On Chart Number 1, Mike, so you're saying these are the State contributions, is that --

MR. GENEST: Yes.

MR. PRINGLE: All right, so the contributions for retirees is the state contribution for retirees, as opposed to the combined contribution for retirees?

MR. GENEST: Yes.

MR. PRINGLE: And, of course, we know what happened in 1999-2000 for those three years in terms of the reduction and the contribution rate.

What percentage of the growth in the red portion of the bar, or the PERS contribution -- is there somewhere that that is ascribed as to the rebound requirement from the reduction in those three years’ contributions?

MR. GENEST: I don't have that off the top of my head.

MR. PRINGLE: But if we were to look at this and to see the constant aspect of a STRS contribution, and not necessarily that grand fluctuation because of benefit changes or anything else like that, there were some benefit changes in PERS. But I would like to see if, through PERS or any place else, they have made some degree of assessment as to those years when the stock market was booming and the state contribution rates were allowed to be reduced, how much of that future growth and that State contribution could be ascribed to that?

MR. GENEST: I think a lot of it -- a lot of it can. I mean, it was done at the time, I think, yearly actuarial adjustments. And so when the stock market went the other direction, that drove up a much larger contribution.

If you're saying how much of it is due to additional employees or additional benefits versus how much is due to just the stock market fluctuation, I think most of the big jump there is the stock market.

MR. PRINGLE: And just in terms of numbers, just so I can kind of have it in my head, on the '01-02 contribution to the '07-08 contribution to the PERS loan, do you know about what the difference of those dollar amounts are?

MR. GENEST: I don't think -- do you have the data?

MR. PRINGLE: I mean, I could kind of put my finger on where I think it would be here versus where I think it would be here, but…

MR. LYNN: It would go from $1 billion to $2.5 billion, essentially.

MR. PRINGLE: All right, and presently -- maybe this is a question for later -- so instead of making the annual adjustments actuarially through PERS as they were allowed to in the past, now it is a blending over a number of years; is that how they are to look at that?

MR. GENEST: Affirmative.

MR. PRINGLE: Is there any -- is there -- presently, is there any restriction to drop it too low? I mean, is there a minimum contribution requirement that the State has?

MR. LYNN: Contributions are set by the PERS board.

MR. PRINGLE: So there's no minimum. So if we do have a number of great years and we get ourselves back --

MR. DICKERSON: In terms of currents policy, there are minimums.

MR. PRINGLE: What are the present minimums?

MR. DICKERSON: That would probably require an assay to give, but there are minimums built into the policy.

MR. PRINGLE: Is there a minimum for the State?

MR. DICKERSON: For all PERS employees.

MR. PRINGLE: All right. Well, I would like to kind of see that maybe later in that discussion, too, to see how that plays in, because I do think that's an important thing to point to.

And to me, from a state/local government perspective, I want to quickly respond to Matt's premise on guiding principles. I like guiding principles. They're lovely.

CHAIR PARSKY: That's not a great introduction.

MR. PRINGLE: The step beyond guiding principles, though, is to make sure we offer a road map for implementation of those guiding principles.

CHAIR PARSKY: Right.

MR. PRINGLE: And I think it behooves us to have some very clear, basic statements as to what we think are good practices.

After that, I think there's a requirement for us to make very specific statements using a lot of what

Mac has presented, because I think those are virtually all recommendations I could support. The concept, though, of how do you force those guiding principles and those grand recommendations to be implemented?

And we all can spend our time focused on the State, and I think we focus on the State because that's a big nut to crack in terms of all of the forces and powers and interests and the big health obligation that's there. I also want to make sure we don't overlook our requirement in terms of schools or in terms of the local government.

And, you know, I know one of the principles that everybody likes to tap on -- some claim that it's a conservative principle, I think it's a marginal principle at best -- and that is of local control. And everyone says we should have local control. But local control is something we don't have in this state; that local governments don't have this broad breadth of opportunity to do whatever they want. They are constrained and confined within a set of guidelines.

And I believe when we talk about these big principles, we also need to ensure that those that are making the decisions live with the consequences. And I think that's pretty much what you're suggesting.

And, one, to be able to define what those consequences are and to make sure that those local officials see those consequences when they make those local decisions. And even in some cases, allow the Legislature to see some of those consequences. But also force -- and I use that word properly -- force local governments, when they do make those decisions in terms of salary and benefit packages, to be required to address those consequences. And that means taking -- you know, we should not obligate future generations with these costs as a basic principle and say, "And when local governments make these decisions, they must address this, they must respond to this, they must at least make a decision publicly as to, 'This is how we are going to pay for that obligation.'"

And what I think our value to, you know, legislative response in a report, is certainly to hit what we found, but also be very precise in offering suggestions as to what is palatable by -- I think in Mac's words, even with the composition of this commission, to be able to offer suggestions that really can be accepted by the Legislature and the Governor, to say, "Yes, these are things that are very specific legislative responses or directives that need to be put into place to address some of these grand guiding principles that we've established.

And I'm hoping we get down to some of that finite discussion, because I think that is a true value we can provide to the Legislature. It's a true value we can provide to the Administration. And it will eventually be the best value, I think, we provide to the taxpayers, to be able to specifically say, "And this is how you fix that." And those are the tougher decisions, maybe, to make than to agree on what some of those big principles can be.

But I don't think we should shy away from saying specifically certain governments have to do this in order to get that. If they take this action, these are the consequences. We believe the Legislature needs to pass a requirement that they have to address the element of their consequences.

CHAIR PARSKY: Okay, Matt, do you want to take the next series of questions?

MR. BARGER: Sure.

Just for your benefit, Curt, I've only shared these principles with the chairman. So I've actually then said, yes, there are some specific things underneath there that you should do. No magic reasons, but I'm sure we'll get into that at some point.

One of the questions that I had that maybe, Mac, you might touch on is, we're very narrowly focused on the pension, and yet, you know, when you read the literature, there's sort of this concept of the three-legged stool of, you know, the employer pension, but also how does that meld in with what Social Security does, and then with, you know, your own savings. And in sort of asking some questions about it, it sort of turns out it's really confusing that, you know, depending on what entity they have Social Security coverage or they don't, or half of them do.

How do you sort of think about that and integrate that into the recommendations you're making?

MR. TAYLOR: Well, I think it indicates why it's so difficult to say, "Here's kind of one plan for everybody."

You heard the firefighters talk about how important their system is that has much more generous benefits, in part, because they're not in Social Security. And they have a much more valuable disability program because they get disabled a lot. So those differences are good things, it seems to me.

As far as the state systems, I mean, we do have a very generous program. Again, that's not a normative; that just a factual.

So your point about the three-legged stool, since most state employees are in Social Security and they have a generous program, if you're a long-lived employee, you don't really need that third leg on that stool very much because you can really retire with a fairly high-replacement income.

So, again, that may be people's preferences and that's okay. They decided that they wanted to incorporate the third stool within their program. I am not sure that's a problem, necessarily.

MR. BARGER: Well, I guess, you don't have a sort of normative recommendation that, you know, for instance, teachers or counties that are, to my understanding are sort of less than half to zero in Social Security, should be in it? Your attitude is, no, that's sort of a local decision?

MR. TAYLOR: Well, that may be a higher level about who's forced to be in Social Security. And the State could certainly -- I don't know what the status is. Maybe Jason knows. But I thought most people, that decision was made that you go into Social Security now or --

MR. DICKERSON: The school district requirements are statewide.

MR. TAYLOR: Yes, I guess it's statewide. So you could make that decision.

MR. BARGER: It's sort of an interesting --

actually, Connie was talking about this to us in terms of competing on the basis of the sort of deferred compensation, current compensation. You're sort of at a handicap, actually, if your county does have Social Security deducted out because somebody who is 25 years old and doesn't put a very high value on the retirement portion of it says, "Gosh, my current compensation is lower than this guy over here whose not in Social Security.” It's not an attractive trade-off.

In some sense, it's a state-mandated thing, so everybody is competing on a level playing field, you get rid of those sorts of issues.

MR. TAYLOR: You could. Again, we didn't make a normative judgment that this is what you should do. It's certainly a consideration.

CHAIR PARSKY: Yes, Teresa?

DR. GHILARDUCCI: I found attractive some of the recommendations that you had, so I wanted to make sure I understand the recommendations that I find so attractive, if that really was what you were saying.

If we could look at slide 7 in Mac's presentation. The first recommendation, you implied, meets Matt's principles, that the current generation pay for the benefits that the current generation gets.

So what I heard was that you recommend that we recommend that we pay for the normal cost of current employees, whether they're new or current, we pay for the normal cost of retirees, which is probably computable.

MR. TAYLOR: Well, I think a normal cost is, in effect, it's saying, "This is the cost of this future benefit that you're going to get."

DR. GHILARDUCCI: But retirees also have a normal cost as well?

MR. TAYLOR: No, not really.

DR. GHILARDUCCI: All right, okay.

MR. TAYLOR: That's what a normal cost is.

DR. GHILARDUCCI: Yes, I know that, but I'll bet they would. But it might not matter for what I wanted to say.

MR. TAYLOR: Okay.

DR. GHILARDUCCI: The next thing -- so I thought you said only the normal costs for new retirees, for new hires. But that's not what you meant?

MR. TAYLOR: Right, no.

DR. GHILARDUCCI: You meant current and new?

MR. TAYLOR: That's right.

DR. GHILARDUCCI: And then you suggest on slide 9, that we shouldn't actually fully fund the past liabilities this year, that we should actually amortize that over a period of time?

MR. TAYLOR: Yes, and I think that meshes with what Mike was talking about, the difficulty.

You could bond it out. That's a financial decision.

DR. GHILARDUCCI: Yes, I'm not talking about that.

I'm talking about how we adhere to the principle that current generations pay for the benefits that they get.

MR. TAYLOR: Again, the question, it's a past generation’s liabilities and who should pay for those.

DR. GHILARDUCCI: So future generations, you're recommending?

MR. TAYLOR: Well, no, I mean, future generations will be paying for them. The question is, which future, which part of it. Us, right now? Our kids? Their grandkids?

DR. GHILARDUCCI: You're saying our kids. I mean, you're doing it over -- unless we all -- unless you're considering the 30 years as being this generation.

MR. TAYLOR: I guess what I was trying to suggest is that you already have an intergenerational problem.

DR. GHILARDUCCI: Right, right.

MR. TAYLOR: And I guess you can make the case that you should start paying them now.

DR. GHILARDUCCI: That's what you -- that's the case you’re making.

MR. TAYLOR: And that's all.

DR. GHILARDUCCI: That's your recommendation?

MR. TAYLOR: Yes.

MR. GENEST: May I make a comment about that, because I think there is a little clarification.

There is sort of three cases, especially in retiree health care. It's different in the systems that are already funded or at least partially funded. But with health care, there is no set-aside funding whatsoever. So there are sort of three cases.

DR. GHILARDUCCI: Right.

MR. GENEST: There's the new employees who are not included in the number that we're working with -- the 47.9 -- they're not included in it at all. So Mac's principle or this principle would say they immediately should start paying.

DR. GHILARDUCCI: You don't accrue any unfunded liabilities with them? Sure.

MR. GENEST: Then there are the existing employees, but they fall -– there are the retirees themselves who haven't paid anything -- or nothing was paid on their behalf.

DR. GHILARDUCCI: Right.

MR. GENEST: And so they're sort of this -- that's what we're paying for now on a pay-as-you-go basis. But then there's the current employees. And if we were to say, "Let's make sure that for new, accrued liability for these current employees that we make a payment," we don't know what that would be because if you take me, for example, on health care, every day I continue working, my accrued liability, my portion of it goes down. Because in the actuary's numbers, I should have retired, and so I would be part of the cost instead of part of the payment.

And there may be people who are even 45 years old who are virtually fully vested, and they can work another 25 years, 20 years, and not add to the accrued liability.

So we want to find out what that number is. We're working with the actuary.

DR. GHILARDUCCI: And you'll have that before we stop?

MR. GENEST: We hope so. But it's going to be a tight one, because they haven't -- for some reason, that's not what they were looking at. And I think they said maybe mid-November they can do it.

DR. GHILARDUCCI: Okay.

MR. GENEST: And we'll get you what we get from them.

DR. GHILARDUCCI: Okay.

And, Mr. Taylor, the second thing you said, I think you alluded to Mr. Genest, that when you, as an employer -- the State as an employer, looks to see what the proper retiree health and pension to pay, you're also looking at cash wages as well, since it is just part of total compensation? That's probably out of our purview, so we're not going to make any normative statements about what the pension should be or shouldn't be. But I do want to say that I think you've simplified it too much by pointing out that you're going to get at that issue by just comparing what like employees in the private sector are getting. So you told us that you're doing this total compensation measure.

There's always been a problem with that when you measure the public employees with private employees. Because if you look at just the cost of what private employers are paying, you might be looking at employers that have virtual pension holidays, who aren't contributing at all and, therefore, their costs look artificially low.

So since you put that on the table, something that we should look at, I really would like to see what the methodology of the total compensation -- that salary survey is, since you've asked us to consider that.

MR. GENEST: That's available on DPA's Web site.

DR. GHILARDUCCI: The web site? Okay.

The methodology and all?

MR. GENEST: Well, I don't know how well it actually explains the methodology.

DR. GHILARDUCCI: Okay.

MR. GENEST: And one of the big weaknesses of it is exactly what you say. We acknowledged, and DPA acknowledged, that its ability to really compare the value of benefits for state employees with benefits for private employees is pretty shaky. We really have a pretty hard time doing that.

DR. GHILARDUCCI: Yes, I know. I don't even know if we can use it.

And then the last point kind of speaks up for professors, but it actually speaks up for the brilliance of the design of the UC retirement system. And it also points out to all of us, is that we may discount very easily the benefits to taxpayers for having a defined benefit system.

So let me just tell you the story of the professor labor market. Because the UC system has a defined benefit plan, your professors aren't really available to the national labor market, especially your older ones and your stars. So nobody even tries to bid them away from the UC system, which means that their salaries are kept much lower than they otherwise would be. And that's a very good thing for the UC system. They are actually able to keep your star professors because they aren't in the same pension plan that practically everybody else is in.

So I think that it's really easy for taxpayers to not appreciate the benefits of defined benefit plans in actually retaining your employees. So I've always argued that we can't, in this commission, just talk about the cost. We also have to have some statement -- it looks like we will, but I don't think we have enough data or enough testimony -- about how important and how available these defined benefit plans are from the point of view of the employer and the taxpayer.

CHAIR PARSKY: I would only add to that -- and I think your point is really well taken about UC. But I come back to this notion that the establishment of this holiday on contributions will come back to harm the system.

DR. GHILARDUCCI: Yes.

CHAIR PARSKY: And I think that it can't be done just on, quote, the backs of the employees. That the employer needs to step forward as well, and much of it has to do with a collective bargaining issue, which we certainly are honoring.

But if we sat here X-number of years in the future, there is no question that the funding would not be there.

DR. GHILARDUCCI: Yes, yes.

CHAIR PARSKY: Yes?

MR. CAPPITELLI: Thank you.

My question is first for Mr. Genest. I was curious about your mention in here about chronic-illness management and wellness and things of that nature. And then also you talk about how possibly decreasing the benefits would -- the blending of all those might lead to some future lower health-care costs.

My question is this: Have you looked at how it might be, or are there any working models that you're aware of, whereby, for example, somebody who promotes wellness and therefore gets a greater return back from the entity? For example, if I'm sitting next to somebody who smokes three packs of cigarettes a day and doesn't exercise and doesn't take care of themselves, and yet I'm doing the same but yet we're in the same pool for health care and the contribution is the same, whether it's for me or for the employer, have you looked at that? Are there any other models that are working of that nature?

MR. GENEST: I'm certainly not an expert on that. It's funny that you would ask because I was here at UCLA last Friday when the Anderson school had a symposium on health care. And I always get my "Blues" mixed up, between Blue Cross and Blue Shield. So I'm not sure which of them it was that was speaking. But they have an active program for their employees that gives financial incentives and health club memberships and other things. And they have -- he said that in the plans they offer private employers, those are increasingly popular.

Other systems have them.

I don't know how rigorously evaluated they have been, but I think they are certainly something that a lot of the health-care industry is interested in. And I know that our Governor's health-care proposal for the broader health-care proposal that the Governor has made, insist that those kinds of things be incorporated.

They sound like they would work. But like a lot of things, until you really see an evaluation, you don't know. But they are being looked at by a lot of people in the health-care world.

MR. CAPPITELLI: And then the other thing I would just want to mention is that I'm anxious to see the actuarial work on this hybrid that you say might be here in mid-November. If there was a way we could get it sooner, I think that would be great. Because I think, mid-November, I think we'll probably be at a point where we may have already talked about some things and it would have been a great value to have.

But that being said, you know, sitting on this commission, I get a little nervous when we start talking about anything that says "defined contribution." And so I'm trying to keep an open mind as to what it is that you're proposing here.

But I believe that, if I'm not mistaken, that our focus here really is to stay more in the defined-benefit arena. And so I'm open to seeing what you have to offer, what you want to propose here; but I'm just a little nervous about the word "defined contribution," especially in light of everything we've said up to this point, as a commission, and what we're working towards.

MR. GENEST: I've learned to be nervous about using it myself, the hard way. I'm not making such a proposal. We're sort of looking to this commission to give us some guidance in that regard. That's only one subject, of course, but it's an important one.

Let me just say, as I think you want to see the data on this hybrid. And I want to see it, too, because I think it's at least conceivable that those three categories I mentioned, one of them, that the hybrid may be the same as full funding in this sense: That the existing employees' new actuarial accrued liabilities each month that they're accruing. But the thing that we would be paying for on a monthly basis, if we were doing full funding, it may be close to zero. I mean, it's even theoretically possible that it would be negative. I mean, for me, for example, it will be. I mean, the longer I work, the less I'm going to be taking retiree health care.

And we do have a pretty old state workforce. So seeing the real numbers on that would be very interesting. But apparently they're very difficult to get, and the actuary thinks it will take several weeks to do it.

CHAIR PARSKY: Just to follow on that, Mac, I know you've made reference, I think, in your presentation on the defined-contribution concept. And I do think that in all of our presentations and discussions, we've stepped back and moved away from the notion that we're going to make a choice between the two. And that is quite clear, I think, that Mike and others may have felt the burden of kind of moving down that path.

However, my understanding of your comments were really oriented around perhaps it creating a situation where those that are denied any benefits because of length of service or otherwise might have had a benefit if they were given a choice or there was an opportunity to be part of, at their choice, as it is at UC, for instance, a defined contribution.

Is that the point you were trying to make?

MR. TAYLOR: Exactly.

I think you can see from my presentation, we're not in any way anti-defined benefit plans.

CHAIR PARSKY: Right.

MR. TAYLOR: It serves a great need.

I don't think you should be fearful of defined contribution plans, though. I think it's just another tool that the State may be able to use.

And think about it this way. Go back to the point about our personnel needs. The State is going to be facing massive retirements. It's already a very tight labor market. We have huge vacancies that we can't fill. And you have a whole world out there that's not the public sector of people who only know about defined contribution plans.

And if in the future we need to access those people, that's a pension program they're much more comfortable with. They may even prefer.

So, again, it's not a question of either/or at all in hour minds; but I don't think you should be fearful. I think it's just another tool in your tool belt.

And as long as, again, people aren't approaching it from, "This is going to replace defined benefit," I don't think you have to be as weary of it, because that's where the whole private sector is. It's an important option for you.

CHAIR PARSKY: Yes, Connie?

MS. CONWAY: I'm not sure if there will be a question in here. It's just, I appreciate the presentations very much, and I'm glad that I'm sitting at the end of this brain trust over here that understands things maybe better than I.

CHAIR PARSKY: The highest brain trust starts at that end of the table (pointing).

MS. CONWAY: I just know it it's everything over there.

DR. GHILARDUCCI: What are we, chopped liver?

MS. CONWAY: No, all of you to my left, no matter where you are politically.

CHAIR PARSKY: I don't think all of all of this crowd is to your left. That's okay.

MS. CONWAY: Okay, a small attempt at humor.

But I appreciate the information on the State, because I'm familiar with -- and in particular, my own -- the counties and the retirement. And so what I worry about and what I struggle with as a commissioner is how whatever generic recommendations, as I'll call them for now, or whatever happens, how that becomes meaningful for all public entities, because of the variety of menus that are out there. I mean, even within PERS, the local governments -- counties in particular that I'm more knowledgeable about -- within that menu, there's probably, within PERS -- and Mr. Walton can say up or down to that -- I don't know, is there four or five thousand different plans even within PERS because the local decision-making?

MR. WALTON: Many, many more than that.

MS. CONWAY: Yes. And so that's how I struggle with this, because there really isn't even one size fits all within every person that's represented with some kind of benefit.

I appreciated Mr. Pringle's comments just because of -- one of the things that I think happens is, especially in county worlds, it's elected officials making these decisions, but they come and go. The employees don't. But, you know, so you have this constant turnover of the decision-maker. And then I have to say, not to be adversarial, but with the State -- I mean, the local liabilities are sometimes determined by the State Legislature when they create a new class of employee -- I'm thinking IHHS for those of you who would ask me what -- and that gets handed down to the local level. And so in my own county, we have three tiers of employees. We do pay into Social Security. Our plan would maybe not be as valuable to the next county's, because we don't pay 3 percent of anything to anybody.

And so -- but we're fully funded. We're okay.

In our world, it becomes not a public versus private benefit, or how you balance that, we're actually public versus public. We're constantly compared to the city next door. And county governments don't have a way to get General Funds, except whatever we're given. So we really struggle in order to pay the liabilities that we have. You know, do we hire fewer police and safety officers and do we not fix roads, which the taxpayers think they're paying for?

So it's a real struggle in my mind. So I don't believe there's a question in here. I'm probably just thinking out loud. I just want to make sure that everybody keeps that in their mind.

I learned a lot about the State and how that functions; but I think my question is, is there a pony in this for everybody? If you guys have the answer to that, I would really want to hear it, because it's just such a wide variety, that we -- and I think this is a difficult task.

And, of course, the health-care thing is just the craziest thing about this all, which is why I think the Governor is very clever, because I know he's looking at health care as a big issue, and we are here to talk about OPEBs. But for a while, I thought all we were talking about on this Commission was health-care benefits.

Okay, I'm done rambling. If there was a question and somebody wants to respond, okay.

CHAIR PARSKY: I don't think any of you should answer "yes" to that question.

Listen, I want to thank both of you very much.

I think it was an excellent presentation. Very timely. And I think there may be some follow-up questions that we would have for you.

Thank you both very much.

MR. GENEST: Thank you.

MR. TAYLOR: Thank you.

CHAIR PARSKY: I would also say that it would be quite helpful, since each of you are highly regarded within the Administration and within the legislative leadership, that many of your views carry the day with both elements of that street as we move forward. We'll count on your help in that process.

Thank you very much.

We have one more presentation, and that's a case study, before we break. So if I could ask that panel to come forward.

And it's particularly important, I think, that we hear from this case study because I think we will find prefunding has occurred here, and it's an important concept that we actually see in practice.

CHAIR PARSKY: Carl, if you could introduce each of you.

MR. FRIEDLANDER: Sure.

CHAIR PARSKY: And then proceed ahead in whichever order you'd like.

MR. FRIEDLANDER: My name is Carl Friedlander. I'm the president of the Los Angeles College Faculty Guild. It's a local of the American Federation of Teachers. We represent full- and part-time faculty in the Los Angeles Community College District. And I am happy to be here with our recently-retired Chancellor, Rocky Young, who we dragged out of retirement to come here today and to join me in this presentation.

In the interest of time and lunch, we're going to dispense with the PowerPoint presentation, which we sent in and which your staff has incorporated, I see, on your Web site. And we thank them for that.

But we do want to talk about the solution, at least partial solution that we feel that we've crafted at the bargaining table in Los Angeles to this problem. I want to give you just a very brief background, and then I'm going to have Rocky explain the concept behind the approach that we've taken.

The L.A. Community College District is the largest community college district in the nation. We have an outstanding benefits program for all our full-time employees and all vested retirees and the dependents of the active employees and the retirees.

Until last year, it was funded exclusively through pay-as-you-go. And we'll get to what we did last year and we'll be doing ongoing.

We have engaged in a very active cost-control program over the years, through a joint labor management benefits committee. And we've struggled with all of the cost-control efforts that probably many people in this room have struggled with in their different agencies. And, in fact, this year we've added to that a very active wellness program, sort of spearheaded by the classified union in the district, in addition to the other changes that we've made over the years. You know, we coordinate our retiree coverage with Medicare. The STRS program has assisted with that, and we're very active in that.

But we have developed a program which we've agreed to in the District, which I actually think in some ways fits within the hybrid -- not a defined benefit type of hybrid, but the kind of plan that Mr. Genest spoke about. It's a plan where for the most senior current employees, there is really zero prefunding for people getting ready to retire. But on a sliding scale, going back to new hires, we actually do, I think, pretty much a full prefunding program. And we did this because we wanted to preserve an open-group system in the Los Angeles Community College District, and did not want to cut off coverage for future generations of employees.

So with that as an introduction, I'll turn it over to the Chancellor to talk about.

MR. YOUNG: Thank you -- former Chancellor.

MR. FRIEDLANDER: Former Chancellor.

MR. YOUNG: What we were trying to do here was that we had actually had anticipated that we were going to be on a pay-as-you-go basis before GASB came out with its regulations, and actually had worked on a budget plan that would have been able to sustain a pay-as-you-go basis. And so that's an important backdrop to our solution here, was that that was part of our thinking.

And the solution that we came up with, of course -- perhaps that's where I should start -- is a year ago, the State awarded to the community-college system a 5.92 percent COLA. And we worked out with the employees, and we were prepared to award a 5.92 percent COLA to our employees. What we negotiated was that for all eligible employees, they would only receive a 4 percent COLA, and that 1.92 percent of gross wages would be contributed every year, ad infinitum, to a fund to help pay for retiree health benefits. So that was the first piece of this, was that the employees agreed to start making the equivalent of an annual contribution, along with the understanding that there would be no effort at any point to try to recover that portion of the COLA that wasn't awarded last year. So that's ongoing.

The second part of that, of course, is that the District also agreed to a couple of other principles. And the two other principles that we agreed to were that any Medicare refunds that we received would all be contributed to this fund as well. And we are getting a fairly significant Medicare D refund.

And the third element is that we are currently spending approximately between 5 and 6 percent of our unrestricted revenues on retiree health benefits, and that we would do that also -- we would continue to do that. And given what our revenue projections were for the District, it meant that we would be able to continue to absorb rising costs in those retiree health benefits.

Now, all of that has a series of variables in it that, you know, will determine the success of this.

The first thing, of course, is the financial health of the District and how long they can continue to absorb the pay-as-you-go, even though our projections are that certainly for the next ten years that is not going to be an issue for us.

The second part of this, of course, is what happens to the actual premium cost, and who do you believe, and do you accept the actuary's assumptions? What assumptions do you wish to use on the actual premium cost? And so that's a second variable to this.

But, in fact, this joint labor management benefit group has actually been very successful in actually controlling our premium costs. It essentially is a situation in which we have effectively delegated the authority to this joint group which is equally split between management and labor, and it allowed them to help make the decisions relative to the benefit packages for employees. And as a result, they have actually made very tough decisions to actually reduce the benefit costs to the District, because that's actually critical to the whole success of this effort, is actually controlling those premium costs. If they get out of hand, then, of course, this whole strategy will fail.

And then, of course, you know, we've made lots of estimations about what the number of retirees are going to be and how long they're actually going to work. And, of course, their actual behavior could change from what the actuary has used, and could also undermine the success of this.

I think the feeling was that this was, at a minimum, a situation in which the District was prepared to do on a pay-as-you-go basis the people who are currently retired that are unfunded, and that we had now begun to put in place a reasonable system that would actually start to fund future -- current employees and future hires. And because we had actually changed the vesting so that you aren't actually fully vested in retiree health benefits until you've served for 20 years in the District -- it's not 20 years of service, it has to be 20 years in the District -- it actually has reduced the eligible pool for this, but without actually cutting it off to future people.

And it does create, as you've suggested

earlier, there is sort of a *golden handcuff*, because at some point they cannot afford to leave us.

The other thing that I would just mention and then give you a chance in a few minutes to ask us questions, but the one thing that we have not done a good job of doing, is that we have not done a good job of marketing the total compensation package that our District provides to all future employees. Because of the fact that we are still continuing to offer retiree health benefits to future employees already puts us into a unique situation that we need to do a better job of capitalizing on, as well as looking at the full benefit package that we offer, both in terms of hiring people inside the state of California, but also in terms of hiring people outside the state of California because they get scared off by the cost of living in Los Angeles.

So with that, we'll open it up to questions.

CHAIR PARSKY: Thank you very much.

I think, just on that last point, I think it would be helpful if you could provide some statistics, if you will, in terms of how a total compensation under this plan helps you become, or remain competitive, vis-à-vis other comparable employees, and give perhaps a couple of illustrations of that, I think it would help us in putting together some of the facts relating to how we want to look at the benefits package in relationship to salary and other compensation.

John?

MR. COGAN: You mentioned in your testimony, in the written testimony, that CalPERS is not open to you.

Could you give us some sense about, what are the big objections to allowing your system into CalPERS?

MR. YOUNG: Well, it's not our objection.

MR. COGAN: No, your objection is to get in, I would think.

MR. FRIEDLANDER: Yes, we want to be in CalPERS.

MR. COGAN: But what are the objections to you getting in? I don't understand why --

MR. FRIEDLANDER: Well, there's actually legislation sitting on the Governor's desk at this moment, AB 554, Hernandez, that will allow agencies that do not -- such as ours -- that do not participate in the PEMHCA health plans to prefund retiree health care through trusts set up through CalPERS. And one of the things that we would ask of you commissioners, any assistance that you can provide in getting that signed, it is the place of choice for our employees. They feel confidence -- our county treasurer -- let me say, we interviewed a lot of possible places to set up our trust.

And our county treasurer in Los Angeles came in and said, "Well, the only place that we will support you putting the money, other than holding it with the county treasurer as we're doing now, is to put it with CalPERS." And now we're sort of all dressed up with no place to go, because we have the money now, we have two years set aside, it's being held by the county treasurer. And we're waiting for the opportunity to set up our irrevocable trust through CalPERS, which we will do if the legislation is signed.

MR. COGAN: So have been the objections by those --

MR. FRIEDLANDER: The bill.

MR. COGAN: This bill was vetoed. As I recall, the bill was vetoed.

So what are the objections?

MR. FRIEDLANDER: Somebody from CalPERS could probably speak better.

There were some issues last year. It's my understanding those issues have been resolved this year and a signature on the bill is anticipated. And I cannot speak to what the details of the objections were.

CHAIR PARSKY: We can call back the Director of Finance -- or the deputy director of Finance. But we've got the director, unfortunately, sitting here.

So we can work on her during lunch.

MR. YOUNG: Great. That would be helpful. Because, actually, the other part of this is an assumption of a rate of return on those irrevocable trust funds that we are not earning at the moment. So it already has set us back, because we were anticipating being part of PERS when the bill was on the Governor's desk a year ago.

CHAIR PARSKY: My understanding is that PERS would welcome you in this mess?

MR. FRIEDLANDER: Yes.

MR. YOUNG: Yes.

CHAIR PARSKY: That's what I understand.

Other questions?

Yes, please.

MR. CAPPITELLI: At the risk of getting beat up because I'm asking a question before lunch, just a quick question.

CHAIR PARSKY: No, that's okay.

MR. CAPPITELLI: I was curious about the joint labor management benefits committee, I see that's been in existence for a while.

MR. FRIEDLANDER: Yes.

MR. CAPPITELLI: And in your document here, you talk about how you've had to make some very difficult decisions over the years.

Have most of those decisions that you've had to make affected employees on a prospective basis or retroactively or by working your system, do I have to worry that next year, maybe this board will convene and say, "Okay, you thought you were going to have this and now you have this"?

How does that work? Can you explain it to me?

MR. FRIEDLANDER: It's been both. It's been combination, changes. Rocky referred to changes in the vesting rules for new employees; but we've also eliminated some, you know, very high-cost plans, changed plans, strictly enforced -- strictly enforced the Medicare requirement, instituted co-pays, deductibles. A whole gamut of changes that we've done over the years. And many of them have affected current employees.

MR. YOUNG: Coordinated benefits between two spouses working in the District and stuff like that. All of those were things that they viewed as being reduction in what they had perceived as their benefit but generated fairly significant cost savings to us.

CHAIR PARSKY: Teresa?

DR. GHILARDUCCI: That all seems like low-hanging fruit.

So to contain your costs. But you haven't really done anything to contain health-care costs. And also -- have you? That was a question. And it seems like changing the vesting rules was probably your biggest cost savings, was restricting the benefit.

MR. YOUNG: Well, it was the biggest in terms of retiree health benefits. It wasn't necessarily the biggest in terms of ongoing health benefits which is obviously an equal concern to us and does affect the retiree health costs because those benefits are extended to them as well. So they go with the changes in the existing plans. So when we reduce them, they get reduced as well.

DR. GHILARDUCCI: And do wellness programs, have they had a big effect?

MR. FRIEDLANDER: It's really just this year that we've instituted the district-wide wellness program. So it's too early.

CHAIR PARSKY: Just to clarify one thing, I think you've said that the senior employees are not under the prefunding approach. What's the determination of “senior employee”?

MR. FRIEDLANDER: Well, I probably phrased that badly.

What I meant was, employees -- the District is putting in 1.92 percent of the previous year's payroll into this plan.

What I was suggesting, though, is that for employees who are on the verge of retirement, the amount of money put aside, obviously, will be very small. But on a sliding scale, the younger the employees, and particularly for new employees, we are looking at a situation of something close to a full funding, although I haven't -- you know, we haven't worked out the numbers.

The 1.92 percent was, frankly, the result of a sort of political compromise in terms of a cost-of-living allowance down rather than an actuarial study calculating exactly what it would cost. But that's our sense, that there is this sliding scale.

CHAIR PARSKY: Thank you.

MR. LIPPS: First of all, is that 1.92 percent of total payroll?

MR. YOUNG: Total eligible payroll, meaning, we don't tax people who are not eligible for retiree health benefits.

MR. LIPPS: Okay, so then you have roughly, what, twice as many part-timers?

MR. FRIEDLANDER: Right, we have -- that's correct. And they got the full 5.92 percent salary increase because they don't participate in the retiree health-care program.

MR. LIPPS: And so there are about 350, according to one of your slides, I think I saw, that do get some partial, the part-timers that do get some partial health benefits.

How does that partial system work?

MR. FRIEDLANDER: Well, they don't get any retiree health care. But while they're active, if they meet certain criteria in terms of the number of classes that they teach and the amount of time they've been doing it, the District contributes -- I think it's currently about $2,160 a year towards their health insurance. And they have to pay the difference between that District contribution and the cost of whatever plan they want to participate in, whether it's just for themselves or for themselves and their dependents. And they do it on a pretax basis, through a premium-only plan.

MR. LIPPS: Do they get the $2,160 regardless of whether or not --

MR. FRIEDLANDER: No, no.

MR. LIPPS: They must participate in a plan --

MR. FRIEDLANDER: Yes, it’s only used --

MR. LIPPS: -- with the District to qualify?

MR. FRIEDLANDER: -- as a partial payment towards premium of a health plan. It's not transferable to salary, if they don't take it.

MR. LIPPS: So are the part-timers, are they primarily hourly?

MR. FRIEDLANDER: Yes.

MR. LIPPS: Okay, so there is sort of -- I guess, Teresa, one of my -- one of the responses that went through my mind in terms of whether or not this college district does engage in cost containment on health has to do with a large number of part-timers they have that are not eligible for retiree benefits, that are also -- and medical benefits that also hourly employees. There's sort of an implicit subsidy there, wouldn't there be, for the full-time regulars who are eligible for benefits?

MR. YOUNG: That depends what you consider the relative comparison.

If you look at the State of California, most of the part-time instructors get no contributions to health care.

MR. LIPPS: So it does vary from community college district?

MR. YOUNG: It does, but many of them get none.

MR. LIPPS: I was just speaking internally within your system, there is an implicit subsidy on the part of the part-timers, of the full-timers for the benefits, when you have such a large -- you have nine campuses, and, what, 3,400 part-timers.

MR. FRIEDLANDER: Right. I think that's true throughout the California community-college system.

MR. LIPPS: Thank you.

CHAIR PARSKY: Thank you all.

Yes?

MR. COTTINGHAM: First, actually, I commend you on your presentation and actually in reviewing your materials that instead of bowing to the hysteria of GASB, you embraced it, and you used it to actually resolve your issues and your problems with one step going forward, waiting for AB 554 to pass so you can get into a larger investment pool and benefit from the economies of scale.

And Mr. Taylor is here also, so I can maybe ask him, too.

You mentioned that because of the system, you're creating the term a "*golden handcuff*" that keeps the people there.

Mr. Taylor, in his presentation, talked about trying to have something for the employees that don't stay in employment.

I would venture to say that when we look at employing people, state or local government or colleges, we want -- we're hiring people we hope we can keep. So I think we want that "*golden handcuff*."

If we give something -- and this is -- if we give something that is a benefit to these people that they can pick up and go, one, we're not -- I mean, the benefit they have is by staying and vesting. If they can pick it up and go, they're not helping the system, the money's not staying there, and that could have an adverse impact.

So do you see a benefit then to having, as you say, the *golden handcuff*, the benefits that would enhance the probability that these employees we hire will stay?

MR. YOUNG: Well, certainly. Because the people that we keep in tenure as faculty members are the ones we want to stay and keep through their careers. So that certainly is an advantage to us to keep those individuals.

I do think where you find it -- this, now speaking not so much for us individually, but the system as a whole -- is it has actually discouraged faculty members moving into administrative ranks where they would actually have to leave the district to assume the positions, because they would abandon those retiree health benefits and they could never get vested in a new system. And so it actually has reduced, I think, the pool of administrative talent throughout the state because of these.

MR. COTTINGHAM: And your system, can they leave that there and apply for it later?

MR. YOUNG: No.

MR. COTTINGHAM: They just lose it?

Mr. Taylor, would you comment on the ability to give limited benefits or some benefits to a temporary employee, or someone that doesn't stay until vesting?

MR. TAYLOR: I'm going to probably disagree with you a little bit. I think we are in a little different world than where I started employment and where there is an expectation from many people that when you started a job, that this might be one that you would stay with for a long time. I can guarantee you, at least when we hired people, that's no longer the expectation of people. There's a lot more movement, there's a lot more portability.

So the "handcuff" term does work both ways. It's great because it keeps your valued employees for a long time; it can also lock you in on some employees you don't necessarily want to keep for a long time.

And again, I'm not trying to disparage anybody --

CHAIR PARSKY: None of whom are in this room, so don't worry about that.

MR. TAYLOR: But I think we need to face the truth here that, again, you have a different world. If the state and local government are going to access people who have not traditionally looked for public employment, you may have to think about different ways to provide the retirement benefits.

So again, I guess, in response to your question, if you can provide a defined contribution plan to somebody who may want to come in mid-career and become a teacher, not for the rest of their lives but for ten years, that may be a very good thing, even if they don't stay until they're 65.

So I don't know if that completely answers your question, but I think we may have to think about things a little differently than we have in the past.

MR. FRIEDLANDER: I just wanted to comment.

I don't disagree with most of that, but I would just say that for the situation that he describes about people coming from the private sector mid-career into the colleges, a far bigger barrier for people is the issue that was discussed earlier of the Social Security windfall and offset provisions for people. So that, I think, is a much weightier factor in people's decision-making if they understand it.

Sometimes people are just ambushed, and at the end of their career, they discover the negative impact on their retirement. But that, I think, is more key for most of our people.

MR. YOUNG: Also on balance, you know, we keep good people. You know, as far as foisting problem people off on somebody else, that's just where we haven't done an adequate job of actually evaluating and culling our own ranks. But I don't think that's our overall strategy.

CHAIR PARSKY: Thank you all very much.

We'll take a break now for lunch. And we'll reconvene in about 30 to 45 minutes.

Thank you.

(Midday recess taken from 12:40 p.m. to 1:39 p.m.)

CHAIR PARSKY: We are going to the next phase. We have Tom with us here at the table.

Where is Stephanie? Is she going to --

Once again, the purpose of this afternoon -- and we're going to try -- I know there are a lot of people that have schedules. We're going to try to complete this by three o'clock this afternoon. So we'll try to be as efficient as possible.

And Commission members have only themselves to blame if we don’t get through the process because there's no one at the table presenting to us.

Again, just as a suggestion, I think what I would like to do is kind of break this afternoon's discussion up into two general categories:

Concepts, which would be broad concepts that the Commission would like to discuss in more depth at each of the next three hearings; and then subjects within those concepts that could lead to concrete recommendations once those subjects were aired completely.

So the purpose here is to see if we can’t get out on the table things we want to discuss conceptually, and specifics in each of the next three hearings.

And I have broken it up into three simply because we have three hearings, and it might be a way in which we could get to a final report.

Now, what I'd also like to do is to ask any Commission members -- and in particular, ask Matt, who's got some ideas -- how we might augment the concepts with what I know he has suggested might include some basic principles that could then lead to recommendations.

So what we're going to do is to put up on the screen each of these three, both concepts and specific subjects.

And let's spend a little bit of time talking about each one, and then come back to whether or not we have the makings of what we would discuss in depth.

So if that's okay, let's just take a look at Concept 1 and some subjects. I think there are six subjects within that concept. We don't need to offer points of view on any of them, other than to say: Is this a concept that we would want to build some recommendations around, and are there some principles that we may want to incorporate in the concept? And then are the subjects ones that we want to talk about in depth, or are there some others, or do we want to eliminate -- we don't want to talk about these subjects in order to get us to a point of recommendations?

So Concept 1, a competitive, affordable benefits package serves the public good by enabling public employees to recruit and retain qualified public employees. That's Concept 1.

And we might build into this concept the notion that came up this morning -- and I know that Matt has an interesting kind of basic principle around, which is something along the lines that this generation is paying for services it receives, not the next generation. In other words, this concept of, what should we burden future generations about if we believe that this is a concept that we can build some recommendations around?

And then you see there are six, and I'm going to let Tom comment about each of these six things. And then let's come back and just talk about Concept 1 and the six areas: Do we want to accept them? Do we want to not cover them?

So, Tom, why don't you go through briefly what the six areas of suggested items are?

MR. BRANAN: Yes, Mr. Chairman, Commissioners. What we have in mind here is, we would like for you to consider if these are things you want to discuss.

If they stay on this list, this first seven, at the next hearing, you'll receive position papers on each of these with some background possible recommendations, and then pro and con argument on those recommendations.

So at this point, what we're just looking for is, is this something that you think is worth being discussed by the Commission.

The first one, "actuarial equivalency," we've been taking quite a bit of poetic license with the actual meaning of this term. But, generally, what we're talking about is, benefits are structured so that if you leave early, you get less; if you leave later, you get more.

Pension benefits, certainly until recently, were based on this principle. I think you could argue that the last round of benefits, although they still honor this principle, they're not as true to it.

And the place that we were interested in putting before the Commission for discussion was applying this notion to health care, so that as you have few pension systems -- well, you have no pension systems; where you would get a lifetime pension after serving five years, we would have the Commission discuss the advisability of having health care so that you would get a lifetime health benefit after five years. So, in essence, in both pensions and health care, the longer you stay, the more employer credit you earn.

CHAIR PARSKY: Let's just pause on that one for a second.

First, with respect to the concept and the first item, would anyone on the Commission object to discussing this in depth at our next meeting?

MR. WALTON: I just have a question.

CHAIR PARSKY: Yes, Bob?

MR. WALTON: "The concept," meaning applying -- the longer you work, the more you get in health care? Or -- and/or the concept of tweaking a formula so you're encouraged to work longer before you retire? Both of those subjects?

MR. BRANAN: That would certainly be available, if that's what the Commission wants to discuss.

MR. WALTON: That's certainly what I would suggest.

CHAIR PARSKY: Okay, any questions or objections?

DR. GHILARDUCCI: No. But I just wanted to say that when staff does prepare this document for us, I would like some attention to the best-practice implementation. Because I am jumping ahead of our discussion, but I very much would like this commission to talk about best practices. Kind of in keeping with what Curt said, that we could have principles until the end of the time, but we need to have some ways to get there. We need to give guideposts for that.

MR. COTTINGHAM: On the health-care issue, you're saying, I guess, you’re looking at the state where in five years you vest in health care. But is that something -- some of these things are negotiated at the table. Are we going to take away the right to collectively bargain for some of these benefits?

MR. BRANAN: I think the Commission's been pretty clear that that is not its role. That what we would do is put forward things that we think are good ideas. The Commission would decide on them. But how they're implemented, I don't think there's any interest in changing how things are settled at the local level.

CHAIR PARSKY: Bob?

MR. WALTON: I would suggest, when we talk about over –- or guiding principles, that we just simply recognize that a lot of these issues are subject to bargaining.

MR. BRANAN: We certainly have. Absolutely.

MR. WALTON: And they should be discussed in that context.

MR. BRANAN: And that's been our operating standard as staff.

CHAIR PARSKY: Okay, next?

MR. BRANAN: The next one deals with part-time employment. And you heard something about that today from Mac Taylor. And it's somewhat the same idea, and that is, if people work, say, for 20 years but they never are full-time employees, so they never qualify for benefits, that's a problem. And that one of the things we would discuss is that people, over time, earn a prorated benefit, either pension -- pensions aren't really that much of a problem because there are alternate pensions available, but to look at a prorated credit for health care.

And this would not be for short-term people or temps, but it's not uncommon to have part-time people work 20 to 30 years, especially in the school systems.

CHAIR PARSKY: John?

MR. COGAN: This one is making me a little bit nervous because it does seem --

MR. BRANAN: I thought that might happen.

MR. COGAN: -- we're going down the road of trying to tell local jurisdictions whether they should or should not cover part-time employees. And I'm not sure that it's a road that this Commission should be going down.

It does seem to me that in some areas, I could see us making recommendations based upon best practices and so forth. But when you're dealing with an issue what we might justify as benefit adequacy, we've got to be very, very careful that we don't just try to impose our value judgments on local governments. I mean, it does seem to me that each and every local government is a very distinct entity with its own problems. No two problems are alike. We have a very heterogeneous state, and we should at least try to avoid imposing one set of value judgments by a dozen members of a commission on them.

CHAIR PARSKY: Bob?

MR. WALTON: Yes, I don't know that I would disagree with John at all.

I think what I read in this is a concept that we currently know that employers purposely hire part-time people to avoid certain costs like health care. And I don't know what the perfect world would be, but certainly an employer has every justifiable reason to hire people on a part-time basis.

I would want to try to remove the incentive or disincentive of covering them under health care as one of those reasons. In other words, the employer shouldn't be basing their part-time versus full-time strictly on the basis, "Well, does that mean I have to pay a health benefit or not?" I think it ought to be based on other legitimate hiring practices.

MR. PRINGLE: I actually agree with both Bob and John on this because I don't agree with your comment that said there should be an expectation after working 20 years that they should have that right or opportunity for health care. Because that’s one thing to say that part-time position is a career choice for some. In many cases, that part-time position is a filling-in of an individual's calendar or schedule or something. Therefore, I think we make a pretty quick assumption that, again, all part-time people are doing it for the same purposes and the same reasons as, say, someone who works at a city convention center for 25 years of a part-time capacity, they want to do that as a supplement to other income or spousal income or other things.

So to make the assumption that somehow that, therefore, is the only path that individual may have to health care I think is an incorrect assumption. So I'm not interested in moving forward with that level of the discussion. Maybe Bob's level of discussion is something I'd feel more comfortable with.

CHAIR PARSKY: What if, on this subject it was moved away from kind of the broad recommendation category and moved into -- if we were going to highlight in our report several case studies of approaches that have been taken, and this subject of dealing with part-time employment was dealt with on an individual local basis, with an overriding, perhaps, concept that this is for the local authorities to deal with on a case-by-case basis, you might be able to cover the subject.

MR. PRINGLE: Yes, Mr. Chairman, if I may.

I see on the subsequent one, there's going to be a discussion of spiking of pensions. And in terms of the whole realm of discussing positives and negatives, employer and employee incentives, I think that belongs in that same area of discussion as to how some employers may use a part-time as a way to avoid certain benefits. And if that is something we want to talk about with those whole employment decisions, that would make me feel more comfortable than highlighted this way.

MR. COTTINGHAM: Okay, we'll keep part-time employment on the table as a discussion topic and then just move to a different area. It is a huge area. I think it's specifically in schools.

CHAIR PARSKY: I was going to say, I think in order to kind of be responsive on the notion of -- I think the general concept of not trying to come up with one solution or one recommendation from this group that might either interfere or not be appropriate at every local level -- a concept that I think John raised, which I think everyone would concur in -- this is something that could be mentioned, maybe along with the spiking issue, but not in the concept of the broad recommendations of this commission but, rather, covered in a recitation of some either case studies or practices that have been used, but selectively used by a local authority.

John?

MR. COGAN: One way, I guess, maybe to think about this is if the issue was discussed in the context of a practice best, so in the case of part-time benefits, if there is a group of political jurisdictions that provide part-time benefits, if we can identify which jurisdiction provides those benefits at, let's say, in a least-cost way or for a given cost which one provides greater benefits, then that seems to fall into this best-practices criteria. But when we get into the world of value judgments, whether somebody should or should not provide a benefit, then I think we're kind of treading on dangerous territory there.

CHAIR PARSKY: Teresa?

DR. GHILARDUCCI: I do think that this subject was a place-holder for us to talk about adequacy. Because time and time again, we've heard testimony that there is one group of workers, classified school employees that are at special risk. So I had an idea that that was a place-holder for that group, so I asked the Commissioners, "Do we want to talk about -- it may seem normative, but do we want to talk about adequacy or special groups at risk or something like that"?

MR. COGAN: We've got 11,000 jurisdictions out there.

CHAIR PARSKY: That’s the issue.

DR. GHILARDUCCI: Yes.

MR. COGAN: That's a tough issue to discuss in an intelligent way.

CHAIR PARSKY: Bob, do you have --

MR. WALTON: I would just suggest, Gerry, that at this point we keep it as a discussion item. At a future point, we can decide at what level we believe it belongs in the final report.

CHAIR PARSKY: Okay, is that okay with everyone?

All right, go ahead, Tom. Next is formulas.

MS. CONWAY: Mr. Chairman, all I was going to say, even if the will is there, it's a question of ability to do it. So that's what I struggle with. It's not that a jurisdiction may not want to do that, it's how could they?

CHAIR PARSKY: Matt?

MR. BARGER: I think there’s just -- this touches on a sort of overarching point, which is the list of specific questions we were asked, you know, for the board that set up this Commission.

CHAIR PARSKY: Right.

MR. BARGER: And it would be hard to ––

DR. GHILARDUCCI: Stuff that in there.

MR. BARGER: -- directly read that into a response to any of the questions.

So maybe this brings up a broader point of, are we willing to step beyond those questions or not.

CHAIR PARSKY: I think that's a good point.

I think that in the, quote, "Recommendations" section of this report, we should stick quite closely to what our charge is. But if we've heard testimony relating to the myriad of needs/approaches at the local level, I don't think it would be inappropriate whether it was contained in an exhibit, in an appendix that relate to best practices, that we begin to highlight what local authorities have been able to do without violating, if you will, the overall charge.

So I think maybe it's cast a little bit inappropriately here because it sounds like within the concept of best practices that may reach beyond the charge, we can bring forward some things that a lot of local authorities ought to be looking at, without it necessarily bogging down, responding to the charge we have.

Does that seem okay?

(A chorus of "yeses" was heard.)

CHAIR PARSKY: Okay, formulas?

MR. BRANAN: The next one, "formulas," comes from testimony that you've received in the past. And it's dealing obviously with pension formulas. And two things have been recommended: One, changing the retirement age; and the other, changing the basis for determining final compensation. And specifically, what you've heard there are recommendations that one year final comp be expanded beyond one year; most commonly suggested, three years.

MR. CAPPITELLI: Mr. Chairman? If I may, I'd like to see these divided really into two parts and not put together. And with that, I think we should steer clear of anything that talks about formulas. Because it's my belief that a pension fund or any type of fund, if it has the proper actuarial calculations, and if it's managed properly and funded properly, it really doesn't matter what percentage is there. And I think we should steer clear of that as a recommendation.

The issue of final compensation I think is something that we could talk about and how that impacts the --

DR. GHILARDUCCI: Spiking or something.

MR. CAPPITELLI: Yes, spiking.

CHAIR PARSKY: How do the others feel about that?

MR. COTTINGHAM: I would echo the same sentiment. Actually, I don't think we need to discuss it at all.

Every formula that can be discussed is available now. When new formulas were adopted, whether they were 3 at 50 or 3 at 60 or one-year final comp, three-year final comp, the old formulas didn't go away, they're still there. So they're still there, they're still available, they're still at the table, they can be negotiated, and we see some of that happening now. So

I don't think there is a need to bring it up and discuss it.

CHAIR PARSKY: Bob?

MR. WALTON: My point, as far as formulas, I think they can be discussed under Item 1, because I think it goes to the heart of -- well, how much to get at what age.

And I would agree that the issue of one-year final comp may be more appropriate to address under spiking, because that's what it's associated with. I don't think they're one and the same. Certainly one-year final comp can lead to spiking.

CHAIR PARSKY: Okay, I just wanted everyone to recognize that all of this information was put on the list not because there was any prejudgment as to what should stay on or not --

MR. WALTON: I understand.

CHAIR PARSKY: -- but, rather, to make sure that, at least from my perspective, I had a sense for where the Commission would like to go.

So it's not offending anyone -- certainly not me --

DR. GHILARDUCCI: To take things off?

CHAIR PARSKY: -- to take things off. It's perfectly okay.

John?

MR. COGAN: You know, I'm very sympathetic to Ron and Paul's point here. I asked myself, if we started looking at benefit formulas, what's the purpose? What's the outcome? Where is our conversation going to go? Are we going to be recommending eliminating, you know, 3 percent, going to 2 percent? Are we going to be proposing to raise everybody up to a 3 percent per year?

I just don't see any useful outcome. It seems to me it falls in the context of almost like a value judgment as to whether the benefits are high enough, whether they're low enough. And I just don't see the value.

CHAIR PARSKY: Is that --

MR. CAPPITELLI: Well said. Well said, yes.

CHAIR PARSKY: I think that's one we'll take off the list.

MR. BRANAN: Yes.

CHAIR PARSKY: The next one, “Three-Legged Stool.”

MR. BRANAN: Just for clarification, Mr. Chair, we're taking off "formulas" but leaving on "age" and "final comp"?

CHAIR PARSKY: I think the idea of age would come off, but the final comp concept will stay on.

DR. GHILARDUCCI: It’s going to go under --

CHAIR PARSKY: Is that right?

DR. GHILARDUCCI: That's going to be in spiking; right?

CHAIR PARSKY: But keyed into the spiking issue.

DR. GHILARDUCCI: Yes, with the abuses.

CHAIR PARSKY: Is that right?

MR. COTTINGHAM: Yes.

Well, from my perspective, I still disagree with putting "final comp" in there and putting it into spiking. The only time it became spiking is the first year or so it came in because it adjusted people going out. After that, it's part of the formula, it's part of the actuarial, and, as Paul said, it should be in your valuation, it should be calculated for in your payments.

So it no longer at that point becomes spiking.

Spiking is a totally separate issue, not related to final compensation of your last year's pay. It's what you roll up into that. So whether it's a one-year, three-year average on pay, it's not -- that's not the real, true spiking; it's what rolls – it’s what you allow to roll up on that. What some government entities have done actually, through agreement of contracts, throw other benefits on to base pay that raises it. So if you leave your final compensation, your base pay, whether it's one or three years, that's not spiking, and I don't think it should be held in the same context.

CHAIR PARSKY: Yes. But you wouldn't object to the concept of final compensation being discussed?

MR. COTTINGHAM: The final compensation as it does relate to spiking, not whether it's a one- or three-year average.

CHAIR PARSKY: Fine.

MR. CAPPITELLI: I agree with that.

CHAIR PARSKY: Do you agree with that, Tom?

MR. BRANAN: Yes.

Three-legged stool was the next topic.

CHAIR PARSKY: Three-legged stool.

MR. BRANAN: This also came from both testimony and from some commissioners.

This could either be dealt with as a recommendation or as a finding. And the reason we put it on is that's the traditional way of looking at how someone puts together their pension. Social Security, savings, and a pension.

What has come out is that, in fact, about 50 percent of public employees in California do not have

Social Security. Other witnesses have said that many people don't save.

What we had in mind here was, if it's a finding, we would simply document those facts. If you were interested in a recommendation, it would go towards something like mandatory savings, that an employer create a separate savings plan on an opt-out basis rather than opt-in. So the Commission could go either way there.

CHAIR PARSKY: Thoughts, Bob?

MR. WALTON: Yes, Tom, I think using the Social Security aspect of this as a finding, as far as here's -- because I think the general public believes everyone's covered.

MR. BRANAN: That’s right.

MR. WALTON: -- and that's not true, and so a finding that this is how many aren't.

I think the other aspect that we haven't really talked about -- and some people may argue -- is I agree that it's part of a three-legged school, but it should be made clear that Social Security is not a retirement plan; that it's a social program, Social Security contributions are not retirement contributions, they're a tax. It has benefits beyond retirement. And so it's really apples and oranges, although they're related. They're both fruit, so to speak. Sorry.

Anyway, I think those are all just facts. And I think it would be good to include those, just so the general public understands how Social Security works in to this equation.

CHAIR PARSKY: John?

MR. COGAN: Yes, I agree with Bob. Getting the fact into this is very important. I think having the staff prepare information for us on the number of people, the number of employees that are eligible for Social Security benefits and so forth, would be a very, very good thing. And the same thing goes, of course, with Medicare.

So I would certainly benefit from discussion -- more full discussion of the three-legged stool context. In the context of an information as opposed to --

CHAIR PARSKY: Facts or finding as opposed to recommendations.

MR. COGAN: Yes.

CHAIR PARSKY: Is that how everybody feels here?

MR. PRINGLE: Not really.

CHAIR PARSKY: Oh, well, then go ahead.

MR. PRINGLE: I mean, because I don't know if I want to even -- personally, I don't know if I want to address the three-legged school discussion as a three-legged school discussion, because we're only talking about maybe one, one and one half of those three legs, so it doesn't make -- if, in fact, we're taking formulas off the table and we're not talking about exact retirement compensation from a pension program, then we take one leg of the stool away.

So I really do think unless -- the other thing we may wish to talk about, but I don't think it's consistent with what our mandate is, necessarily -- is talking about how to encourage governments to create incentivized, directed savings accounts and programs like that.

I don't necessarily think part of our job is to figure out where we wish to create additional benefits.

I think this whole issue is talking about Social Security. And I don't want to move forward under the concept that we can't make recommendations. I mean, it's great to get the findings in the report. I want to be in the position to hear kind of the discussion on Social Security, Social Security participation from various areas. And then if this Commission chooses to make a recommendation in some fashion, then we should be in a position to talk about that.

So from my perspective, I'd just as soon talk about this in the context of Social Security and public employee participation and Social Security, and allow us to hear that presentation and make that recommendation.

CHAIR PARSKY: I think that's consistent with what others are saying, and I think that's fine.

We were not necessarily ruling it out, but at least get the facts on the table and see whether that results in a recommendation on that end.

And to cover Medicare, I think as well as Social Security?

MR. COGAN: Yes, you wonder if localities were aware of just how generous Medicare was going to be 30 years ago, whether you'd have state employees now that are not covered by Medicare. And so I think there's a valuable role that we have in getting information out on the Medicare program.

CHAIR PARSKY: Okay, that's fine. We'll -- the concept of three-legged stool is out the window, but you've got the --

MR. BRANAN: The one-and-a-half-legged stool.

MR. COGAN: Yes, it doesn't stand up very well.

CHAIR PARSKY: I would take "legged stool" out of the title.

MR. BRANAN: I think so.

MS.GHILARDUCCI: But one subject came up, do we want to take about mandate, or nearly mandate a DC portion on top of the DB plan?

That was talked about a little bit. Ohio and Indiana have it. The tax treatment.

Is it here?

CHAIR PARSKY: I'm not quite sure whether the concept of DC is here or at one of our other categories. There is no question that addressing the issue and the fear relating to the words "defined contribution" is appropriate.

MR. COTTINGHAM: I would offer something. Instead of saying something that we would look at a DC plan, what a lot of local governments have brought in as part of their package for their employees whether they will contribute or not for the employees, is the tax-free 457 plan --

DR. GHILARDUCCI: Yeah, I think that's under --

MR. COTTINGHAM: That we have a hard time -- we don't have as many of our employees taking advantage of that as they should.

And I know from the association viewpoint, we try to encourage them that, you know, you're not going to retire on your retirement alone. You need something else, you need a savings plan, and that's it.

CHAIR PARSKY: Well, and that may fit under the category of "best practices" as well. Our way to address this, I think, comes in the context of best practice, maybe.

DR. GHILARDUCCI: Yes, and I think it's under tax issues, too.

CHAIR PARSKY: And you have tax as a way to bring it also.

DR. GHILARDUCCI: I think that’s where it is. That's where it is, yes.

MR. BARGER: Calling it DC may be inappropriate. It's called “voluntary savings.”

CHAIR PARSKY: Yeah, I'm not quite sure – well, we may want to say something about the notion that we're not making a recommendation to cut off defined benefit plans and move to defined contribution plans.

DR. GHILARDUCCI: Yes. I like that –- yes.

CHAIR PARSKY: But to talk in terms of savings or forced savings, or however we want to express it, may be very appropriate -- or incremental savings.

There’s a way to -- the word "forced" is a little bit --

MR. BARGER: Compound interest.

DR. GHILARDUCCI: I have “mandate voluntary plans.”

CHAIR PARSKY: "Understanding of Vesting," go ahead.

MR. BRANAN: Number 5 came primarily from public testimony that you heard in your earlier hearings, where it was clear that retirees thought they had a vested health-care benefit; and it turned out, in fact, they did not.

So what we're looking at here, the Commission could look at recommendations on how that information could be made more available, probably more often by employers to both their actives and probably just as you begin to retire.

CHAIR PARSKY: Bob?

MR. WALTON: Yes, I think this is a very important point, but I think it's also important, Tom, that we make a distinction, because I think it's vastly misunderstood. There's really two aspects of vesting, and the term is used interchangeably where it's really inappropriate. That one vesting is when I begin employment, my employment contract entitles me to certain benefits, that's vesting; separate and distinct from, I have to work five years to get employer contribution for retiree health care, or so many years to retire. That's a different aspect of vesting.

I think they're used interchangeably, and it shouldn't be; and I think that ought to be made clear.

MR. BRANAN: I agree.

And what you'll see in our written material as we submit it to you, is we have pretty much used vesting for pension benefits eligibility for health care, so that we're trying -- or eligibility requirements, because it usually isn't as clear with health care.

CHAIR PARSKY: Does that seem okay?

Okay, next, "Part-Time Employee and Retiree Access to Health-Care Risk Pools." It's a little bit lengthy, but go ahead.

MR. BRANAN: This also came from both public and some of your expert testimony. It was talking about the advantages of having people in pools for health care and access to those pools by people who normally don't have it.

CHAIR PARSKY: Any objections or thoughts there?

MR. WALTON: No objection.

I think the only caution I would urge is that we may want to hear from PERS or others about the potential of adverse selection of allowing people outside the program to have eligibility under the program, and the potential cost of that.

CHAIR PARSKY: Okay.

MR. BRANAN: And number 7, we've called it "Medicare-Eligible." This is simply that people who are

Medicare-eligible should not be allowed to remain in the basic health-care plan. And that's just because the plan then is spending money that it doesn't have to spend.

CHAIR PARSKY: Well -– I'll let everybody else comment. Go ahead.

MR. COGAN: Go ahead.

CHAIR PARSKY: Well, I guess the question, really, here goes back to what our charge is, what we should be focusing in on. And, you know, for us to pass a value judgment on whether or not someone is getting a benefit they're not entitled to, I'm not quite sure --

MR. BRANAN: Mr. Chair, that's not what I meant. This is people who -- they're in a basic plan now and they qualify for that plan. But when they hit 65, they stay in the basic plan rather than being moved to a Medicare supplement plan.

DR. GHILARDUCCI: When they could.

CHAIR PARSKY: When they have the right to, you mean?

MR. BRANAN: When they have a right to.

And the employer, that's just money that's being spent that the employer wouldn't have to spend.

MR. COGAN: I agree that it's money spent by the employer that he wouldn't otherwise spend; but you have to ask yourself, why is the employee staying in the program? Maybe the local program is better than Medicare for that person's needs.

So shouldn't it -- if we're interested in the employees, shouldn't the employees get to choose? But more generally, I guess, I would say again, we should stay away from these kinds of value judgments, that the employee is making the judgment that he or she prefers the local program over Medicare.

Who are we to say, "No, the employee should be forced into Medicare?" But it's another thing to say, "All right, maybe some employees end up in their local plan because they are unaware of just how generous the Medicare program is. And I can sort of see in that case a real value of providing to the individuals, although I'm not sure that's our role at this point.

MR. BRANAN: Well, I think one of the things that we were supposed to do, was the second direction by the Governor, and that was to explore ways others have found to save money in these fields.

And PERS can certainly give testimony to how much money they saved when, relatively recently, they went in, found all these people, and put them in Medicare. And they saved a lot of money.

CHAIR PARSKY: Well, I think if part of our findings was to accurately reflect a policy that CalPERS adopted, that's one thing, if that's something that we want to highlight, and CalPERS comes forward and makes it clear exactly what happened. But I think the way it's expressed here, Tom, would suggest that we were going to pass a value judgment on this concept.

MR. BRANAN: I understand that. I think part of our problem today is simply how I've worded some of these.

MR. COTTINGHAM: Does this come under -- I mean, I know '37 Acts that do the same thing, and maybe this comes under best practices.

MR. BARGER: Could we just maybe get testimony on it and understand why people are doing that, and then make a decision about what we want to do with it?

MR. PRINGLE: I think that's a good recommendation.

I know many local governments -- we were focusing again a lot on CalPERS and what CalPERS medical plans offer. But many local governments that manage them themselves, such as '37 Act counties and, I know, cities like ours, that has been part of the collective bargaining agreement that we've had with all of our unions. And we do have that as a requirement because there is such a substantial savings.

So to at least hear how many governments have chosen that path, you know, and we choose it in the collective bargaining way; but, in fact, demonstrating it in the best-practices format may be a good way to make sure that information is presented.

CHAIR PARSKY: Well, it seems to me that at the next hearing, as we cover these items, we'll want to have someone from CalPERS indicate exactly what the meaning of this is from their perspective and their feelings about it.

MR. BRANAN: Okay, and I think also we probably can have someone from Los Angeles County also.

CHAIR PARSKY: Okay.

MR. BRANAN: I should say, just for clarification, we as staff understand that you're not going to be mandating anything on local government. So perhaps it's just -- I was making that assumption when I worded these, but it obviously wasn't coming across. But that is our understanding.

MR. PRINGLE: Well, I would hope we do mandate some things.

CHAIR PARSKY: Well, if you want to reconstitute the authority of this Commission, you can do that as the mayor. However, we don't have authority to mandate anything. We can make strong recommendations and shine a light on it.

MR. COGAN: Is the mayor saying that he would rather have somebody else make those tough decisions?

MR. PRINGLE: No, because, actually, we've made those tough decisions. And part of, again, if we look too narrowly at State employees that are participants in PERS, I think we're losing the full mandate of what this Commission is about.

CHAIR PARSKY: That's true. Good point.

MR. PRINGLE: Therefore, there are many cities and elected officials that do feel, particularly in a term-limited environment, that they have six, eight years’ worth of service on their local boards, that they don't see the full consequences of their actions. And part of what I think is available, when the State imposed a class-size reduction program, none of that was mandated on school districts. But if they wished to participate in certain funding programs, they did adopt those programs.

Therefore, the definition of "mandate" can be redefined as a definition of a proper incentive provider. And I think there are times in which proper incentives need to be provided to local governments as well.

MR. COGAN: I withdraw my question.

CHAIR PARSKY: That's why he's mayor and you're a professor -- although this is your classroom here, so it's okay.

All right, so let's move on to kind of Concept 2. We're going to cover all of those items.

And we would address that concept and those items in our next hearing.

MR. BRANAN: That's correct.

DR. GHILARDUCCI: One other -- under "affordable benefits" -- wait, sorry.

You told us we could add something?

CHAIR PARSKY: You may.

DR. GHILARDUCCI: Okay, I would like more testimony, or get our hands around how important these benefits are for attraction and retention, so the personnel -- the human-resource aspect of these.

CHAIR PARSKY: Coupled with this concept of total compensation?

DR. GHILARDUCCI: No.

CHAIR PARSKY: Or what is it that you're --

DR. GHILARDUCCI: We heard testimony that these are vital for employers to attract the right kind of employees; and then we heard testimony that, "The only reason I came to public employment is because of these benefits."

And since our mandate is to evaluate the advantages and disadvantages of various approaches, one of the things we have to consider is the advantages of funding retiree health. You know, what are those advantages? And one of them would be personnel advantages.

CHAIR PARSKY: Well, certainly within the broad concept, namely of -- the message coming out of the broad concept, at least from my perspective, was that we wanted to continue to encourage public employment, and that the benefits package afforded is an important component in doing that.

So it would be consistent, I think with that --

DR. GHILARDUCCI: Right, right.

CHAIR PARSKY: -- to begin to get some commentary on the importance of this benefits package in that concept. So that, I think, certainly we could do.

Okay, next?

And I think I started down the path of including one of the basic principles. I think that Matt had it in the first concept. I think maybe it fits a little more strongly in the second concept because it's in this concept that we get into the idea of pay-as-you-go versus prefunding.

DR. GHILARDUCCI: Right.

CHAIR PARSKY: So I think maybe we'll revise, to some extent, the overriding concept to build. But the concept is the costs of promised benefits should be fully identified and known. The process for funding those benefits should be clear, easily understood, and actuarially sound.

And built into that would be a subprinciple of the notion that the next generation should not be called on to pay for benefits that are created now, something like that, that we may want to elaborate that general concept on; and then we can get into the underlying items. And we can deal, I think, Matt, with a number of the things you raised under that basic principle within that.

Okay, proceed ahead. Number 1?

MR. BRANAN: Number 1, "Mitigation of Market Volatility." This came out of expert testimony that you received. And it deals with sometimes wild fluctuations in the employer contribution rate in public pensions. And there have been at least two suggestions that you've heard more than once. One was the idea of no employer contribution holidays; and the other is something that PERS has recently put in place, and that is an extended smoothing period. I think obviously there are different approaches to the same problem, but that is something that we would be prepared to give you background on if you choose to discuss it.

CHAIR PARSKY: How do you people feel about that?

MR. CAPPITELLI: What did Commissioner Pringle refer to that as? Some type of incentive, and not a mandate? But I think this is something that really needs to be solidified. You know, no holidays and spreading the cost over time, I think it's very important.

CHAIR PARSKY: Well, we could move away from mandate and still cover the subject by indicating that, as a matter of policy, it doesn't appear that the idea of creating holidays -- certainly we could point to the University of California, if you wish.

MR. CAPPITELLI: To use examples, yes.

CHAIR PARSKY: But we may want to address it a little more broadly.

I know that maybe a couple of the commissioners -- the mandate of saying, "No holiday under any circumstances" may be somewhat offensive to several commissioners. So I think we want to be careful about how we do it. But I do think the subject is worth discussing.

Bob?

MR. WALTON: I would agree a hundred percent.

And I think it's not absolutely every time, because there could be very limited, but some exceptions, i.e., what is commonly called "super-funded." That there's also federal tax laws that may preclude you from making contributions into a plan that’s super-funded.

But I would agree that certainly a strong recommendation from this committee as a best practice, whatever, that there ought to be a smoothing technique in place. And we could use in a model what PERS does or what others do, that's not necessarily the perfect model, but just as an example.

CHAIR PARSKY: I think that's right.

MR. COTTINGHAM: Let’s say if an employer gets a holiday, the employee gets a holiday.

CHAIR PARSKY: I don't think we want to move in the direction of creating more holidays. We may not want to mandate more --

MR. COTTINGHAM: I think now, in most of the systems, the employee pays, no matter what. Sometimes it is negotiated differently -- well, it may be in your contract that your employer is picking up that cost for you, but the employee has always had to pay.

CHAIR PARSKY: Well, I would say at UC that's not quite true. But others, that may be.

Yes, Curt?

MR. PRINGLE: If I may, Mr. Chairman.

I just want to know if maybe someone could help me with, how many -- other than the '37 Act counties and CalPERS pension programs and CalSTRS pension programs, what else would we be dealing with here?

MR. BRANAN: Other types of systems?

MR. PRINGLE: Yes.

MR. BRANAN: There are independent systems around the state. Cities, two counties. There's I think about 90 retirement systems in the state.

MR. PRINGLE: A total of 90?

MR. BRANAN: Obviously, many of them are small.

CHAIR PARSKY: How many charter?

MR. COTTINGHAM: Are there charter cities and counties that have established their own?

MR. BRANAN: Some of them, yes.

MR. PRINGLE: So beyond '37 Act counties, there are other counties that may have their own?

MR. BRANAN: There's San Francisco and San Luis Obispo. Those are the only two counties.

MR. PRINGLE: I mean, under state law, I believe there could be a restriction on going below a certain percentage or extending the holiday beyond X-amount. I mean, there could be state restriction on CalPERS, for example, in that regard; couldn't there be, constitutionally?

MR. BRANAN: I don't think that you could given Proposition 162.

MR. WALTON: It would take a constitutional amendment.

MR. BRANAN: Yes. This would be more of a best practice and highlighting a problem.

CHAIR PARSKY: Okay, let's move on to the next one.

MR. BRANAN: The next one, "Tax Issues." This is based on the testimony that you heard from Robert Blum, I think two meetings ago. He is scheduled to come back at the next hearing to refresh your memory on these topics. But, generally, the ones that we were most interested in would be to change either existing practices at the IRS, or what he has found are contemplated changes that impede prefunding.

CHAIR PARSKY: Bob?

MR. WALTON: With all due respect to Mr. Blum, I don't think there's uniformity and agreement that there is a tax issue here or not, on the one that he specifically brought up.

To the extent there may be, I don't have any problem addressing it at all. But I just think we have to be very careful as assuming there's an issue there. That may or may not be true.

CHAIR PARSKY: I think he raised a couple of issues where he thought a recommendation coming from this commission could have an impact on the IRS. And I think not necessarily at the next hearing, but at the hearing that this list of issues, which would be the hearing afterwards, we will want to have him come forward and clarify that, if we're going to include this item.

Okay.

MR. BRANAN: Number 3 is "Intergenerational Cost-Shifting," and we've talked about that at some length today.

One thing that we thought would be worth talking about, and that is, what is a lifetime? What is a generation? Some people are saying 30 years, others 20. I heard today that a common actuarial lifetime is 17 years. So that's something we could bring up.

MR. COGAN: Would this discussion take place in the context of measuring unfunded liabilities or would it come up in some separate way related to a policy?

MR. BRANAN: I think that under this topic, it would be more along the lines of who is paying for the benefits enjoyed today.

CHAIR PARSKY: Bob?

MR. BRANAN: It really wouldn't matter how large they were.

MR. WALTON: Personally, I believe that it's an issue we need to discuss.

And I think, again, going to the concept, a basic principle that you ought to pay for benefits as they're earned, you know, that's a given. But then you get in, okay, how do you do that? What's a generation? And there isn't a 30-year or some other number. Is something that can be pointed out is, "Well, here's some options that ought to be considered in making that determination”?

The other issue that I'm not sure you meant to incorporate in there, but I think we need to discuss, there is an unfunded liability for a past generation. And it's impossible to pay for that as it was earned because those people are already retired, specifically in health. And how is that addressed?

CHAIR PARSKY: Go ahead, Matt.

MR. BARGER: This came out of a point I made, which was what's the magic of 30 years? That's a GASB number just picked out of nowhere. And I think the point I’ve had was, you know, to the extent that you incur the benefits, you should get the costs. There is the big one that has already been incurred, but most of that has happened within recent years, I believe.

And so I was trying to get to, what is a reasonable number to say you should amortize that liability over, without sort of just defaulting to the GASB 30.

Does that seem okay?

MR. COGAN: Yes.

DR. GHILARDUCCI: Okay, so that's that.

CHAIR PARSKY: That's that concept.

MR. LIPPS: Gerry, if I may, I don't mind discussing this. I'm just not exactly sure where we're going with it. And as we talk about passing on cost to future generations, you know, certainly that sounds almost abhorrent. When we think about it, the real logical extension of that is, we should never adopt a state bond that's paid over 30 years. There are enough costs that are passed on to other generations because they benefit from the work that was done by this generation.

I'm not sure -- if we're talking about amortization -- you know, I certainly don't want my kids to pay for things that I incur. I understand that entirely. But I'm not sure where we would be going with this concept unless it was to get to, "Well, then we have to do some sort of mandatory prefunding." You know, that's the local extension of not passing on any costs to future generations, but I just wanted to raise that particular point.

CHAIR PARSKY: Well, again, I do think what you just said is something we do need to talk about because it seems to me that there's a broad choice, once you've identified the magnitude of the problem, there is a broad choice that says, "Do we want to leave things as they are," which I think, if left alone, the policymakers would say, "We don't need to prefund anything. We'll just continue to go along as we've been going."

Or do we want to say, "No, this is not good policy. You need to address" -- as we were talking about this morning, "You need to address this at the top of your priority list. And consistent with that, some element of prefunding is required.”

So I'm not saying where this commission wants to come out, but it seems to me that we can't avoid discussing that subject. And I think I would see that in this -- I see this in that context.

MR. COTTINGHAM: As it relates to prefunding, we're not totally in this generation trying to eliminate any future liability, because that really is going to drive up costs.

CHAIR PARSKY: No. And I think coming out of the testimony this morning and coming out of the discussion -- I mean, again, I don't want to speak for this Commission, we've got to kind of air it -- but I don't think I've heard anything that would suggest we were going in that direction.

MR. COTTINGHAM: Okay.

CHAIR PARSKY: Okay. Go ahead.

MR. BRANAN: "Funding Benefit Changes." This is something that has both come up in testimony and somewhat recently in the press. We saw it more as an informational item. But we have our contract actuaries are preparing a short paper that looks at the pros and cons of both retroactive application of benefits or prospective only.

CHAIR PARSKY: I do think having that data before the future policymakers is a good idea.

Whether you call it an information item or whether you call it a best practice or whether you call it -- I mean, you can call it any number of things. But I think the concept of retroactive benefit increases is something this commission ought to at least talk about.

Bob?

MR. WALTON: I would agree. And especially in the context of something that I think is on the next page, is disclosure of cost.

CHAIR PARSKY: Right.

MR. WALTON: And I think that's critical, because when there's a benefit change, there's two key costs. What's the normal cost increase, that's the ongoing, and what's the unfunded liability cost increase.

CHAIR PARSKY: Exactly.

MR. WALTON: And those are often misrepresented, if not misunderstood. And I think to the extent we can clarify what those are and bring sunshine to those numbers, I think it's really a critical part of our task.

MR. CAPPITELLI: Is this better-served down here in the next block? Because it sounds to me more like an actuarial issue.

CHAIR PARSKY: Do you mean in the next category?

MR. CAPPITELLI: Yes, it sounds more like an actuarial issue.

I'm just offering that up for -- maybe it fits down here a little bit better.

CHAIR PARSKY: Well, I guess the question is, the cost of promised benefits should be fully funded and known, as the first sentence of that category. This might fit within. And maybe it's not -- maybe it's a finding. Maybe it's in that category.

But I think that's why you included it, right, Tom?

MR. BRANAN: That's correct.

CHAIR PARSKY: Okay. Well, maybe leave it in place for the moment, and we'll include it in that hearing.

Okay, next?

MR. BRANAN: Number 5, "Pay-as-you-go vs. Prefunding." And that would be a discussion of the relative pros and cons of each of those since they're so central to what we've been looking at.

CHAIR PARSKY: Next?

MR. COGAN: Actually, if I could supplement, maybe, the discussion. It does seem to me that we want to really seriously explore the pitfalls. We would all agree that there are big-time advantages of prefunding. But we, as a commission, should be very, very keenly aware of some of the pitfalls that might arise as we move down this road, as various jurisdictions move down this road. And think of things like Prop. 98, is there an interaction there? Is there not? I don't know. But I'd certainly like to know the answers to those kinds of questions.

MR. BRANAN: But we did intend pros and cons of each approach.

MR. COGAN: I'm saying, look, we're all aware of the pros. Focus on the cons, so that we all know exactly what we're getting into.

MR. BRANAN: That's so negative.

CHAIR PARSKY: Well, I think the follow-on point there is that we don't want to make a recommendation in this area that is somewhat hollow, because it doesn't fully take into account the restrictions that exist on policymakers. So we want to make sure that we lay out our understanding of that, even if we start at the notion of fully prefunding.

If you start there, what are the impediments to actually getting there? And once we take that into account, we still, in Mr. Cogan's words, we can force the policymakers to it -- or shine a light on the policymakers that this is something at the top of their priority list, they can get done for the following reasons.

Is that right?

MR. COGAN: Yes.

CHAIR PARSKY: Okay, keep going.

MR. BRANAN: Number 6 --

CHAIR PARSKY: You can tee up another one that's easy for people to endorse.

MR. BRANAN: Okay, this is a good one. "Funding Mechanisms." We see this also as informational also or a finding.

Since so many of the case studies are going to be talking about a particular funding mechanism that an agency has chosen, this was more of just a quick rundown on what they are and their relative pros and cons.

CHAIR PARSKY: Does that seem okay?

MR. BARGER: The only thing I'd say about that is OPEB bond. Most of these are vehicles. The OPEB bond is actually a funding source, just to draw a little distinction there.

MR. BRANAN: Sure.

CHAIR PARSKY: Right. And I guess maybe in one sense we've got kind of two broad concepts in the overall concept. One is the costs to be identified and known, and then the funding of those.

This would certainly fit within there, but --

MR. BARGER: For my part, I think OPEB bonds are a serious issue that people are –- that is worthy of its own little --

CHAIR PARSKY: Its own category?

MR. BARGER: Yes.

DR. GHILARDUCCI: Separate.

CHAIR PARSKY: Okay, I'll maybe break that out separately.

MR. WALTON: I think I would agree.

Tom, was this in the context of only health?

MR. BRANAN: Yes, that's what we had in mind.

MR. WALTON: It sounds like we may want to have a separate on pension obligation bonds for pension obligation because that's certainly an opportunity available to local government. But it has its pros and cons.

CHAIR PARSKY: I think that's a good idea.

Okay, Tom?

MR. BRANAN: The next is the question of “Protecting OPEB Funds.” And that has been, again, in the case studies we found agencies that have chosen irrevocable funds and their trusts, and those that are less than that. And, again, there are pros and cons to each approach.

DR. GHILARDUCCI: Are VEBAs going to be in Number 6?

MR. BRANAN: Yes, they are.

CHAIR PARSKY: VEBAs are in Number 6, yes.

Is that, okay, on Number 7?

Okay, 8.

MR. BRANAN: Number 8 was something of a repeat. It's "Pooling and Cost-Sharing." And that's, again, looking at health-care pools, and then options for sharing the costs for health care.

CHAIR PARSKY: Does that seem okay?

DR. GHILARDUCCI: Do you mean if, when you pool a risk, how you share -- what is it --

MR. BRANAN: I think we saw it more -- actually -- yes, we've been seeing pools as a starting point.

MR. CAPPITELLI: Like PEMHCA, to pool?

MR. BRANAN: Yes, like PEMHCA, as opposed to depooling.

DR. GHILARDUCCI: What's cost-sharing?

MR. BRANAN: Well, once you have a pooled rate, then does the retiree pay for all of it, does the employer pay for some of it?

DR. GHILARDUCCI: Oh, okay.

MR. PRINGLE: Not between agencies, but between the --

DR. GHILARDUCCI: Between the employee and the employer?

MR. PRINGLE: -- employee and employer.

DR. GHILARDUCCI: Okay.

MR. BRANAN: Unless you could get another agency to pay your costs.

MR. COGAN: You did have the federal government doing that earlier with Medicare.

DR. GHILARDUCCI: Yes, we did have the federal government.

CHAIR PARSKY: Okay, Tom?

MR. BRANAN: And the “Impact of Cost Containment." And this is something I know we've heard from at least one of our commissioners, and that is the relative effectiveness of different cost-containment methods for health care, say, premium increases versus increases in co-pays.

DR. GHILARDUCCI: The premium affects everybody, the well; and co-pays affects the sick?

MR. BRANAN: And their relative effect upon usage.

DR. GHILARDUCCI: Got it.

MR. COTTINGHAM: You said you're including wellness programs, educational programs?

CHAIR PARSKY: Well, was that included -– was that in costs? I didn’t read that into this.

DR. GHILARDUCCI: I didn't, either.

MR. BRANAN: Well, it certainly could, if that's what the Commission would like. It falls under "cost containment."

CHAIR PARSKY: Bob?

MR. WALTON: I'm not sure if this is the right place, and the rest of the Commissioners may not agree that we should even discuss it, but we've had testimony that a cost of a public employee, both active and retired, that liability, up to 15 percent of that cost is due to the underinsured or not insured, and should that be a point that we make in this proposal. In other words, if somehow -- I'm not suggesting any means or method because there's many out there -- that the underinsured and non-insured are covered, we would reduce our costs by 15 percent, period.

CHAIR PARSKY: Well, I guess it's a fact. But I certainly don't think we will want to give the public policymakers an excuse for not addressing the magnitude of these costs.

MR. WALTON: I guess my point is, there ought to be a fact –- I'd be fine with the fact -- that the public sector, public employees, are paying for a large segment of the uninsured.

CHAIR PARSKY: Mr. Cogan I know has a comment.

MR. COGAN: Having written a paper on this fact, I can assure you, it is far from a fact, that is, 15 percent is far from a fact.

So I guess I'd say as a general matter here, the magnitude of this cost-shift has been estimated anywhere from around 1 percent, up to the 15 percent that some claim. So I would say maybe we should recognize that there is some cost-shifting going on, but I don't think it would be appropriate for us to find a fact in this 15 percent.

CHAIR PARSKY: Okay. I think we can move off that slightly.

Okay, does that seem okay for that category?

All right, let's turn to the third category now. We'll put that up on the screen.

"In order to build awareness, support, and trust by taxpayers, including the employees of public agencies, the process through which benefits are adopted, modified, and/or paid for needs to be open, transparent and defensible."

MR. PRINGLE: Mr. Chairman?

CHAIR PARSKY: Yes?

MR. PRINGLE: On that, I guess I'm kind of missing the opening statement that you made at each of our Commission meetings. And I thought here would probably be the best place to modify this preamble a bit, or this kind of mission statement.

Also, where is there the awareness and presentation to the taxpayers of the obligation? This, to me, looks like –- I mean, I don't necessarily see in here --

CHAIR PARSKY: Well, the second concept -- as I say, it's got two parts to it. One is, the costs of promised benefits should be fully identified and known. In effect, the taxpayers should know what these benefits are and the magnitude of them.

MR. PRINGLE: All right, therefore, if I could maybe add an additional one to that second set of categories.

I would really like to see in some fashion that we have some consistency in reporting and some ability to have on an annual basis all governments be able to present to the public some objective standard by which that unfunded obligation is presented. And we agree ahead of time as to what those are and it's a certain set of actuarial responses.

And you know what? We can all argue about, is that the true unfunded obligation or not; but at least you have kind of an objective standard by which everybody can be measured.

And if that's where that would belong, I would like to have that discussion under maybe that second.

Where do you think that fits?

MR. BRANAN: Mr. Chairman, that actually comes under Number 3 of our third principle.

MR. PRINGLE: Oh, Number 3 of the third one?

Well, when I read that, it said the Commission could discuss ideas for encouraging timely reporting, as opposed to kind of objective uniform reporting.

DR. GHILARDUCCI: Uniform.

MR. BRANAN: Well, yes.

CHAIR PARSKY: You may want to combine that with Number 1 under 3.

MR. PRINGLE: You know what? If it goes back into 3, and that's the way to do it, that's good. I just want to make sure --

CHAIR PARSKY: The point is well taken.

MR. BRANAN: Agencies will now have to report annually on their OPEB liability; and we have at least a working agreement with the cities and counties, that they would support legislation saying that local agencies have to report this annual liability, and we don't know yet to whom, maybe the Controller would.

MR. PRINGLE: Yea, and I know where that discussion is going. And I guess I worry about the subjectivity of that reporting. That actuarial assumptions can vary dramatically between agencies.

Is there that one entity that really feels like they want to be disclosed on a very, very conservative way of that unfunded obligation, they may look really bad, compared to one that feels a little more rosy in their assumptions?

I'm just trying to figure out how it could be presented in an objective way. And at least we could talk about the value of doing that in one of those places.

CHAIR PARSKY: I think we ought to cover these points.

The way I read -- and when we talked about this, Tom, before putting this up -- 1, 2, and 3 are supposed to get at what you're talking about, I think, Curt, in some form or another.

MR. PRINGLE: Okay.

CHAIR PARSKY: All three of those together were meant to address it. But I think maybe we want to clarify it a little.

But the actuarial review panel, the actuarial assumptions, and the timeliness of reporting were all meant to try to address greater public awareness, more commonality of the way you go about calculating the magnitude of the liabilities. All of that is inherent in those three, it seems to me. Now, that may not be worded quite right.

MR. PRINGLE: And you should probably put also that level of unfunded obligation in the preamble portion, because that doesn't reference that in Number 3.

CHAIR PARSKY: Okay.

MR. PRINGLE: That's more in Number 2.

CHAIR PARSKY: Bob?

MR. WALTON: I don't know that I think I would agree with most of what's been said. I think we have to be very careful here to somehow articulate in a report that what the unfunded obligations, or the obligation of the retirement system -- what it's based on.

Factually, there's more than one way to calculate that number. There's more than one acceptable way to calculate that number. And one shouldn't assume they're all done the same. I don't know that it's possible to do them all the same, or even appropriate, for that matter. But, again, I think there's accepted actuarial practices. And a best practice would be consistent with those actual practices.

But to make sure the public understands, it may not be based on the same process and valuation, but it should be based on an accepted actuarial methodology.

MR. BRANAN: And that goes to a potential role for Number 1, for the statewide actuarial review panel?

MR. WALTON: Absolutely, absolutely. That's what I see there.

CHAIR PARSKY: John?

MR. COGAN: In this discussion of item Number 1, it would be really helpful if you have a recommendation, or a set of recommendations, as to how this statewide actuarial review panel is going to be appointed. I think it would be very, very helpful. You know, it's one thing to talk about in the abstract. It's another thing when it goes through the legislative meat grinder, what comes out.

MR. BRANAN: We have two volunteers from --

CHAIR PARSKY: Differently from how this Commission was appointed.

MR. BRANAN: Well, one thought on that is --

MR. COGAN: There are exceptions, Gerry.

MR. BRANAN: One possibility is that they would be associated with the Legislative Analyst, who was the office that Mac Taylor was representing today.

MR. COGAN: Great, great. Yes, I think what we want to hear is the --

CHAIR PARSKY: We want to hear some thoughts about that.

And I think you're right, John. I think here we should make a strong recommendation that tries to preserve the quality, if you will, of what's going to come out.

Okay, so 1, 2, and 3 seem okay.

MR. WALTON: I have additional comments on Number 2.

CHAIR PARSKY: Okay. All right, I'm sorry, yes, this would get into some of Matt's comments, too, so we should pause on Number 2.

MR. WALTON: On Number 2, I think in the report, as a finding, I think the public ought to know the provisions basically of Proposition 162, that public pension plans in California are subject to those provisions. There are pension boards under each of these systems, or over these systems.

And I would argue that -- well, factually, members of pension boards are legally fiduciaries. And as a fiduciary, they must do this. It's not an option, they must do this. They're legally required under Prop. 162 to do this. But they can't just accept what is given to them. They have a duty to make sure that it's valid information that they're being presented with.

Now, I'm not suggesting all of them do that; I'm just suggesting, that's what the law requires as a finding and as a best practice, maybe would be a better way to put it.

CHAIR PARSKY: Okay, Matt?

MR. BARGER: The second principle that I sent Gerry.

It strikes me that when you focus only on actuarial assumptions or accounting assumptions, that you are missing something -- and I made this point earlier -- for instance, we were missing entirely retiree health-care obligations up until last year, even though they obviously were there.

And I think the sort of general principle is you want to have realistic financially based, transparent, real-time accounting and, you know, with the principle, the numbers are intended to illuminate, not sort of disguise and, you know, sort of specific comments. I mean, I don't know how you get there, but having common actuarial assumptions within the state seems an obvious point, so you compare oranges to oranges when you look at these things.

I'm shocked to discover that there's not sensitivity analyses on some of these key things, like health-care inflation. There is just, "Here it is," and no sense of, "What if you're wrong by 1 percent, what does that mean?" That's the important variables, you've got some sense -- how wrong can you be?

And then there's sort of -- you know, there are reasons why the actuaries report the liabilities the way they do. If you looked at it, I think, on a financial basis, you discover they're using a discount rate that equals the assumed investment rate. If you looked over on the financial side, you'd discover they use it based on a liability rate, which I think would be more sort of a financially consistent basis.

When you do that, you obviously end up with much higher liabilities, and it calls into question sort of how well-funded are you on your pension plans and how big a hole is there actually in the health care?

And it's -– people have used sort of the analogy of, well, it's mortgage, what difference does it make? The State's going to be there, it can pay taxes, et cetera, et cetera. And I think that's a wrong approach, in that, you know, bad information leads to bad decisions. And you can think of some examples like when you're sitting there, trying to design your mix of current compensation and deferred compensation, if you misvalue the deferred compensation part of it, you're going to get your offering wrong.

You certainly create more of those little peaks where you're above -- you know, where you feel really good and you have those temptations to give away some of that good. If the line above which that peak has to go is higher, that's less of an issue.

You're encouraged the way things are to have a riskier investment policy than you might otherwise, because the more risk you take on that side, voila, the lower your liabilities are. I'm surprised, actually, that it's only 7¾. If I were in those shoes, I'd probably be arguing for 10.

So I think there's sort of a discussion point on -- obviously, I think Rob touched on this, there's lots of ways to present numbers. But one of them, in my thinking, is sort of financially based. And I think time is going to catch up with this point. It is something that's being talked about in GASB right now, and sort of at least being aware of what the implication of those numbers are I think would stand people in good stead. Because I think if you're setting out five years, it would be hard for me to imagine that that isn't going to be what the GASB principle is.

So I add "financial" into this as opposed to merely just actuarial.

CHAIR PARSKY: Well, and I guess within financial -- I'm not quite sure that we could reach necessarily agreement on whether financial estimates ought to replace actuarial estimates.

MR. BARGER: I wasn't suggesting that.

CHAIR PARSKY: No, but we certainly should have it out there as a way in which you can look and plan for these liabilities. That seems to me --

MR. BARGER: And I think that's sort of one aspect of it.

I think some others that were touched on, there's some narrowing assumptions like, you know, most of these numbers only show closed groups; when they really should be looking at open groups, that if the State is going to continue hiring more people, it's got to plan on that basis.

So I think trying to have these be sort of as realistic to what is actually going to happen as possible just makes sense for how do you manage them.

CHAIR PARSKY: Right.

Okay, Tom, you got that? Are you okay there?

MR. BRANAN: Yes.

And there's a letter in each of your binders where the Commission has requested from the Controller additional sensitivity analyses on those same topics.

CHAIR PARSKY: Okay. Next.

MR. BRANAN: Spiking, this is something that came up at our last hearing. The witness had a document he called, "30 Ways to Spike Your Pension." We've given those to PERS, STRS, and LACERA, the Los Angeles retirement system, and asked them to respond initially by putting their definition of spiking for a beginning. And then they've gone through and responded to each of his claims. And we'll have those for you by the next hearing.

CHAIR PARSKY: What's your suggestion in terms of how this subject fits in? Along the lines of what Curt was saying, or how do you --

MR. BRANAN: Well, it's something that is often talked about. Certainly different things get dragged into it.

One of the things that your witness was talking about was one-year final comp and how it relates to spiking. He has lots of different topics, most of which California has recognized and dealt with already. But I think that is worth putting out in front of the public as well because there are lots of pension spiking claims. And this is a point-by-point refutation of many of those claims. And those that the Commission doesn’t feel have been addressed properly, that's something that you could act on.

CHAIR PARSKY: How do people feel about that? Bob?

MR. WALTON: I think spiking is something we have to address. I think, in the overall scheme of things, I'm not sure it's significant, in the overall unfunded liability or liability of a pension plan. But it certainly is the perception of the public that it's significant. And I think to the extent that we can identify it and report on how it's being addressed, whether we put that in the context of best practices or something else. And the definition is critical.

MR. BRANAN: Yes, it is.

MR. WALTON: I've said before, tongue in cheek, that spiking is what someone else has. If I have it, it's creative financial planning. It's just in the eyes of the beholder. But I think also there's other ways to address it that certainly could be just an observation or just the fact that there are a few states that address this simply by, "We're going to limit the amount that your final compensation can increase during your final comp period to a flat percent. Ten percent, 5 percent -– you know, pick a number, it's arbitrary.

And no matter what additional compensation you receive during your final comp period, your retirement is only going to be based on X or Y, or whatever that number is. I mean, that's an easy way to do it. On the converse, my suggestion would be that everybody's will increase, whatever that cap is, during their final comp period, which may not be appropriate, either.

But I think it's something we need to look at simply because of the focus that's been brought on this in the last several years.

CHAIR PARSKY: I think focusing on it, and at least being in a position perhaps to lay out the facts -- the testimony would suggest it's broad-based, it's across the board, it's a huge problem. And if we have evidence that suggests it has been addressed in a number of instances, at the very least, it will, quote, “shine a light” on that. And on those -- perhaps those entities that haven't addressed it.

MR. WALTON: Correct.

MR. COTTINGHAM: I would suggest, can you send that to Ventura County also? Because Ventura has had two lawsuits that it would help to identify, I think, what some of these people came and said was spiking, that the courts have identified that as actually part of your base pay because of the compensation level. Because these are the things that people throw out as spiking when they just don't understand that it actually becomes part of your compensation and your pay.

CHAIR PARSKY: Matt?

MR. BARGER: I probably echo Robert's comments, but my suspicion is we're not talking about large dollar amounts, but we are talking about the credibility of the system.

MR. BRANAN: Exactly.

MR. BARGER: And the one that -- the question I had is, are you only talking about PERS? Because, obviously, there's all these other levels of --

MR. BRANAN: No, we'll be talking about the three largest systems. And that's PERS, STRS, and LACERA from Los Angeles County. And each of them is responding in writing to the handout that our witness had.

MR. BARGER: how does that -- I mean, just sitting here, thinking a minute, there's all these other jurisdictions.

MR. BRANAN: Actually, most of the bad publicity -- and I will say, the original version of our principle here had the term "actions that bring disrepute on retirement systems. But I was overruled as "too nineteenth century." But that --

CHAIR PARSKY: We're trying to move him into the 21st century.

MR. BRANAN: Good luck, yes.

DR. GHILARDUCCI: You still have disrepute.

MR. BRANAN: But that is exactly -- I don't think anyone has ever said that spiking is going to break the bank. But it lends itself to very spectacular and ugly stories, and so it does have to be dealt with.

MR. CAPPITELLI: Can I just make a comment? This is probably going to be for the discussion we’re going to have when we finally get this out, but I think we need to draw a distinction between the term "spiking," which has a negative connotation to it, which is probably an unscrupulous practice, versus what I believe Ron is talking about, which is enhancements that are vested rights or guaranteed to an employee as a result of some court decision or something that determines that to be part of their compensation package, depending on what they do.

And they are two very distinct things. And I would be concerned about us lumping everything in together and calling them all one, because we're all in for a big battle down the road if that's the case.

CHAIR PARSKY: I think inherent in what we're saying is that we would try to clarify what should be referred to as spiking and what should --

MR. CAPPITELLI: We'll call it something else.

CHAIR PARSKY: Well, we'll go back to the nineteenth century.

MR. CAPPTELLI: Okay, yes.

DR. GHILARDUCCI: Just a comment.

CHAIR PARSKY: Yes?

DR. GHILARDUCCI: I would like to see in your memo the way ERISA dealt with this issue, because it's already been discussed on the federal level.

MR. PRINGLE: Mr. Chairman, if I could, just a little add-on to what Paul said.

CHAIR PARSKY: Yes.

MR. PRINGLE: I want to make sure we keep it as "spiking." Because at the end of the day, who is going to read this report? If we make it so ambiguous internally, it's difficult for people to figure out what we're talking about. Let's just put it out there. I mean, I wouldn't mind putting it out there with the 30 things that were submitted by Ted Costa and respond to them, and then make recommendations on things that haven't been addressed. Then at least we're talking the same language that everybody else talks about. And, in fact, if there's three, four, five things that the court has ruled that this is not defined as excessive wrong, this is consistent with law, or this is a vested right, let's put it there.

So we are just responding very clearly and concisely with the people in the vernacular in which people are familiar with speaking and, you know, not nineteenth century, maybe now. And I just think it carries a lot --

CHAIR PARSKY: It has a lot more weight.

MR. PRINGLE: -- more weight.

CHAIR PARSKY: Like I said, we brought it to the 21st century. I knew exactly what you were going to say.

MR. CAPPITELLI: Spiking, whether real or perceived.

MR. WALTON: Paul makes a good point. I think, it's important, again it's a matter of perception. But to make a clear distinction on what we mean -- and I don't have any problem calling it "spiking," not at all. But spiking doesn't necessarily infer that it's legal or illegal.

CHAIR PARSKY: Right.

DR. GHILARDUCCI: Right, or whether it’s legal.

MR. WALTON: It’s a concept. As an example, if I, through further education or whatever means, receive a promotion that's a 30 percent salary increase, do that for a year and retire, that I spike my pension? Well, it's certainly something beyond what the actuary assumed I would receive. So under that definition, it's spiking.

On the other hand -- I don't think most people would say, "No, that's really not spiking."

On the other hand, if I tell Johnny that works for me, "Johnny, you've done a great job, I know you want to retire. If you’ll agree to retire in a year, I'll give you a 30 percent increase in your salary." Now, I would say that's spiking.

CHAIR PARSKY: Well --

MR. WALTON: It's in the eye of the beholder.

CHAIR PARSKY: Maybe we'll clarify the heading and discuss this.

Spiking that hurts the credibility of the system, and then go on to describe exactly what we're talking about.

Okay, next?

MR. BRANAN: The next is "Disability Fraud." This came up from the public testimony, primarily, and also some commissioners have expressed interest in it.

What we had in mind here was to simply put in front of the Commission those bills already before the Legislature that deal with this topic. It would be informational.

CHAIR PARSKY: Okay, keep going. Number 6.

MR. BRANAN: I'm trying to remember what I was thinking of with Number 6.

CHAIR PARSKY: Have you thought about it?

MR. BARGER: Well, You skipped over 5.

CHAIR PARSKY: Oh, okay. This one --

DR. GHILARDUCCI: 5, what are you thinking about in 5?

CHAIR PARSKY: These are the legislative proposals.

It's an information item put before us all of the legislative proposals that are out there to deal with that subject.

DR. GHILARDUCCI: Okay.

MR. PRINGLE: Well, is the question then, do we want to throw out some of these things? Because if we do, maybe that's one we do.

CHAIR PARSKY: Oh, you mean as a --

MR. PRINGLE: At some point in time, I don't know how we do all of this, but at the end of the year --

CHAIR PARSKY: That's fine, that's fine.

MR. PRINGLE: -- are we going to make recommendations on every one of these topics?

CHAIR PARSKY: No.

MR. PRINGLE: I think part of our discussion is, which ones do we really want to focus on?

CHAIR PARSKY: I think we can eliminate that.

MR. BRANAN: True.

6 –- excuse me, I mean 5.

CHAIR PARSKY: 5.

MR. BARGER: The only thing I would say about that is there's the whole subject -- I mean, just the other one I hear from people is "chief's disease."

DR. GHILARDUCCI: Yes.

MR. BARGER: And, you know, again, I'd doubt if it's a big amount of money but, again, it's one of those things that calls into question the credibility of the system and calls into question people's support for it. They feel people are gaming it.

DR. GHILARDUCCI: Yes, we should really talk about it.

MR. BARGER: And somehow --

CHAIR PARSKY: Maybe, again -- we've got to get the word "spiking" in, it sounds like to me. But maybe we want to have a category that says, "Abuses to the system" or "policies that" -- or "actions that hurt the credibility of the system." And include in that, the concept of spiking and this concept, kind of within that overall category.

DR. GHILARDUCCI: That was Tom's point.

CHAIR PARSKY: Okay, Number 6?

MR. BRANAN: Number 6 was -- what we had in mind here was more sunshine on the process of granting benefits. And you've heard testimony and suggestions for a couple of things. One is to better publicize the results of collective bargaining agreements, to make them more known to the public.

Another is a model that's used in a couple of jurisdictions here in California, and that is that the local voters would have to agree to any benefit increase.

And the final thing that we put in here is to let the public know the advantages that they get from having public retirees spending their checks in their jurisdictions.

And there have recently been three studies done by SACRS, PERS, and STRS. And SACRS is all of the twenty '37 Act counties showing that economic impact.

CHAIR PARSKY: Well, I think people on this Commission would find this one interesting as I went over it with Tom. I thought it would evoke interest.

Go ahead.

MR. WALTON: Tom, I think, to some extent, 7 could be incorporated into 6, or vice versa. I know that PERS has a legal requirement for public agencies to disclose publicly the cost of benefit improvements. Simply stated, I think that policy and law could be strengthened significantly over and above what it is today. I don't know what '37 Act has, I don't know what other systems have. But I think that's something that needs to be looked at, and what improvements could be made in that process is something we ought to consider.

MR. BRANAN: Yes, because as you say, there are legal requirements, but there are always skillful people who have figured out how to get around those requirements, so that, really, the public doesn't hear the cost of that.

MR. WALTON: That’s exactly my point. And I think that area could be strengthened significantly, so it ties into both 6 and 7.

CHAIR PARSKY: But maybe I guess you have kind of three, Tom, separate concepts built in:

One is publicizing the results of collective bargaining agreements;

Two, requiring voter approval;

And three, making the public aware of the economic.

There’s kind of three different concepts, all of which I think raise interesting concepts for this Commission.

MR. COTTINGHAM: I can see making the public aware. In most areas, there is interest and coverage on your contract. Most of the public really doesn't care. But if you're going to say -- I mean, what's the point of having an elected body, an elected board of supervisors, and an elected city council, mayors, if everything you do is going to have to be thrown back out to the public? It's just going to stifle your ability to do business. I mean, you're going to sit down at the table and negotiate these things, and then you can't have anything until you go back to the public and they approve the package.

So I don't -- I really don't think we need to advocate that we need to go to a public vote for benefit changes.

CHAIR PARSKY: John?

MR. COGAN: I do know that San Francisco --

CHAIR PARSKY: San Francisco.

MR. COGAN: -- has such a system. And somehow it works because they have collective bargaining and then they have voter approval.

And so I, for one, would just be interested in knowing how well it works, what the benefit consequences have been, do they provide adequate benefits in San Francisco. I believe they do, but I'm not sure about it. And so I think I'd benefit from a discussion.

It does get around one problem.

MR. LIPPS: We did ask for that information very, very early on.

MR. COGAN: And I don't think we've seen it.

DR. GHILARDUCCI: Yes, we did --

MR. COTTINGHAM: I think we were told out of 150 proposals, 35 of them passed.

CHAIR PARSKY: But I think the question relates to, if San Francisco has adopted it, the question is, is it working, how is it working, does it --

MR. COGAN: And not go to the recommendation yet. Not at all. I'm not thinking about going there. I'd just like to find out how well it's worked.

DR. GHILARDUCCI: We heard that Georgia and Oklahoma had a similar check -- a similar governance procedure.

MR. LIPPS: That was a two-year -- those were -- the bills could not be passed in the same year that they were proposed. It had to roll over for a year.

DR. GHILARDUCCI: Yes, but it's the same idea. It’s the same idea.

MR. COTTINGHAM: But besides San Francisco, I think L.A. City has a proposal that certain benefits have to be approved by the public.

MR. BRANAN: There are a few places.

MR. LIPPS: Well, also in K-12 education, all collective -- by law, all collective bargaining agreements have to be disclosed as to the current-year cost and the cost for each of the two subsequent years. And that's a public disclosure requirement for all collectively bargained agreements.

And in addition, each year, three times a year, when the District adopts its budget and issues its interim reports, it also has to do the current year's budget and budgetary projections for each of the next two years, including the projected increased cost of collectively bargained agreements as well as other, you know, kind of standard assumptions.

So those disclosures are already made, at least for K-12 education as a matter of law under both AB 1200 and AB 2756, I think it was.

MR. BRANAN: But those standards still don't apply to cities, counties, and special districts.

MR. COTTINGHAM: No.

MR. BRANAN: They have separate disclosure requirements.

MR. PRINGLE: What I hear we're talking about is the value of what information we've yet to have really presented to us. So the question before us is should this information be presented to us, and let us talk about it during a hearing.

CHAIR PARSKY: Does everyone agree that the information can come forward?

Okay, let's move that.

Keep going.

MR. BRANNAN: Number 7, "Actuarial Review" --

CHAIR PARSKY: Well, I'm blaming it on the Commissioners.

Go ahead.

MR. BRANAN: "Actuarial Review of Proposed Benefits." This is another sunshine proposal.

What we had in mind, in the late 1970's, the Senate Retirement Committee in the California Legislature had an actuary on board, and no pension bill could be heard until the actuary had done an actuarial analysis.

So we would throw that out for consideration.

MR. COGAN: As a possible best practice?

MR. BRANAN: Certainly.

MR. PRINGLE: Statutory requirement.

MR. BRANAN: And also, along those lines, perhaps the mandate that an actuary be present to -- an actuary do an actuarial study of proposed benefit increases at the city and county level, and even if the Commission were interested, that that actuary testify, so that it couldn't be put on the consent calendar. So that's what we would bring to you on those.

CHAIR PARSKY: Okay, no objections?

Number 8.

MR. BRANAN: “Board Composition.” And this, we're just looking at questions of what should the requirements be for somebody who is on a pension board, and governance of the board once they're on it. This would be a best practices.

MR. WALTON: Again, I think that goes to Prop. 162, and what they're required to do as fiduciaries to be educated. And I think that's important, that it ought to be --

MR. COTTINGHAM: I think Prop. 162 also has the makeup of the board, so…

MR. WALTON: Proposition 162, as I recall, states that if there's an elected member on the board, meaning, elected by the membership of the system that it's going to govern, that the composition of that board cannot be changed without a vote of the district that that -- if it's a county, then the county has to vote on it; if it's a city, then the city has to vote on changing the composition of the board.

MR. BRANAN: That's correct.

MR. WALTON: It doesn't dictate a composition, but it says you can't change it without a vote.

Q. BY CHAIR PARSKY: Okay, 9?

MR. BRANAN: 9 is more governance, and it's dealing with conflicts of interest by pension-board members. And there are some legislative examples, if you'd like.

CHAIR PARSKY: And you could incorporate the pay-to-play concept in there?

MR. BRANAN: Certainly.

CHAIR PARSKY: I think Matt had that as something he thinks we ought to at least talk about.

MR. BARGER: Again, sort of abuse through the employer's side.

MR. BRANAN: Not that we require pay-to-play.

CHAIR PARSKY: No, no. We could impose that requirement on staff, but we don't want to do that.

Does that seem like it's a way to proceed ahead?

Okay, each of our next three hearings we'll cover one of these --

DR. GHILARDUCCI: I have a comment.

CHAIR PARSKY: You're going to be responsible, you know?

DR. GHILARDUCCI: I know, I know. I'll do it quickly.

It's come up that a best practice in a pension fund is that the employees and the employers understand the benefit. And I know that's come up when we talked about whether or not people understand that they're vested or not vested in retiree benefits; but I'm talking about something even more basic. And I think I sent a memo out to folks that most people who are under 40, in a defined benefit plan, don't know it. And 30 percent of people in a defined benefit plan over the age of 40 don't know it. And I think that their supervisors don't even know how to explain it.

So instead of -- so best practice, instead of just handing the booklet to the employee, that it's actually discussed.

CHAIR PARSKY: Okay, yes?

MR. PRINGLE: I don't know if time allows today, but maybe at the beginning of our meeting next, that, in fact, we discuss how we wish to move forward with recommendations.

I know it's been your goal, and it certainly is a laudable goal, to have consensus recommendations and maybe some consensus guiding principles that these are up here. But in terms of a lot of those specifics, there may be some, for whatever reason, that consensus cannot be established. I don't necessarily know that that's possible.

But I certainly feel very comfortable in trying to advance as direct recommendations as possible. And if some of those do not have a hundred percent unanimous concurrence that, in fact, there could be a set of threshholds established that I would say that some that are adopted by two-thirds of the membership of this body, those are put forward, and even in consideration of those that may be adopted by a majority of the membership of this body. And under that scenario, allowing for a minority opinion to be expressed as well.

In other words, I would like to at least have the discussion of what is the best way to really get some strong suggestions moving forward? And maybe that's the first level of discussion we might be able to address when we get back together.

DR. GHILARDUCCI: When we get back together again.

CHAIR PARSKY: Some of that may cause us never to get back together.

No, it's really up to the Commission as to how we want to proceed.

Now, certainly my overriding goal was to see if we can't get this Commission to make recommendations as a body. Because I think it carries with it the strongest opportunity for those whose audience we are looking to, namely, the people that appointed us, to take it seriously as opposed to put it on the shelf. So I think what I'd certainly like to do, is to see, as we get into these discussions, to see really where we are, and then come back around and say, "Well, we can't get there on an issue that is of burning importance to one or two or three Commission members."

I continue to have maybe more optimistic hope that we can get out there something that the entire Commission can both endorse and that will be listened to.

A number of us around the table have been on commissions, both at the federal level and at the state level. And the more there are minority reports, the easier it will be for policy members not to take it seriously.

So let's just -- I'm more than open to see where we can go, but I would strongly recommend that we stay on a path of seeing where we can get by having unanimity.

And if there's an elected official on this body -- there only is one --

MR. PRINGLE: There's two.

CHAIR PARSKY: Oh, two, sorry -- no, I was going to make a joke. I won’t do it.

MR. PRINGLE: Not at her expense but maybe at mine?

CHAIR PARSKY: Since you're the one that raised the subject of conflict and all. That's okay, though.

No, no. Look, let's just see where we're going. I'm very encouraged by moving the discussions forward on these subjects. I don't think there's a subject we will discuss that we don't have the potential to reach unanimity about. Now, let's just see where we go from there.

And unanimity may be eliminating. We'll see. But we'll come back around before we're finished. But I really appreciate everyone's cooperation. Let's take it one more hearing at a time.

MR. CAPPITELLI: Can I make a final recommendation?

For those things that we mentioned to Tom to bring back to us, to evaluate, can we draw the distinction between those things that will require testimony and people that actually come in, and those things that will be material for us to evaluate that we can agendize, publicize, so that everybody can see them, and then we can come back and say, "Okay, are there any thoughts or comments on this?" Because I think that will save some time.

CHAIR PARSKY: Well, I would like to move us toward discussion on each of these items with some experts in the audience, either the staff can call on --

MR. CAPPITELLI: Yes, yes.

CHAIR PARSKY: -- that will clarify issues that we have, rather than -- I mean, I think we've got to move into the phase of not just hearing more testimony, but making sure that each subject matter, as issues come up, we have the ability to be responsive on.

MR. CAPPITELLI: Absolutely.

CHAIR PARSKY: Thank you all very much.

Our next hearing is in Fresno, and it is on October 10.

(Proceedings concluded at 3:25 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 2nd day of October 2007.

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