STATE OF CALIFORNIA

PUBLIC EMPLOYEE
POST-EMPLOYMENT BENEFITS COMMISSION

PUBLIC MEETING

Defining Solutions for California Local Issues

Wednesday, October 10, 2007
10:09 a.m.

California State University, Fresno
Residence Dining Facility
5241 North Maple Avenue
Fresno, California

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

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A P P E A R A N C E S

PUBLIC EMPLOYEE POST-EMPLOYMENT BENEFITS COMMISSION

Commissioners Present

GERRY PARSKY, Commission Chair
Aurora Capital Group

MATTHEW BARGER
Hellman & Friedman LLC

PAUL CAPPITELLI
San Bernardino County Sheriff's Department

JOHN COGAN
Stanford University

CONNIE CONWAY
Tulare County Board of Supervisors

RONALD COTTINGHAM
Peace Officers Research Association of California

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

JIM HARD
President
Service Employees International Union Local 1000

LEONARD LEE LIPPS
California Teachers' Association

DAVE LOW
California School Employees Association

CURT PRINGLE
Mayor, City of Anaheim

ROBERT WALTON
Retired (CalPERS)

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A P P E A R A N C E S

PUBLIC EMPLOYEE POST-RETIREMENT BENEFITS COMMISSION

PEBC Staff Present

ANNE SHEEHAN
Executive Director

JAN BOEL
Staff Director

TOM BRANAN
Policy Director

STEPHANIE DOUGHERTY
Research Director

MARGIE RAMIREZ WALKER
Office Manager

--OOO--

Public Testimony

FRAN BLACKNEY
California Foundation for Fiscal Responsibility

IRENE RANSOM
California School Employees Association

STANLEY L. MCDIVITT
City of Fresno Retirement System

DAVE KEHLER
Tulare County Employees Retirement Association

KEVIN SMITH
(for James Hackett)
SEIU Local 521

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A P P E A R A N C E S

Presentations

STEVE KEIL
Director of Legislative Services
California State Association of Counties

DWIGHT STENBAKKEN
Deputy Executive Director
League of California Cities

Subject Matter Experts

PAUL ANGELO
Actuary

JOHN BARTEL
Actuary

GRANT BOYKEN

DAVID CHRISTIANSON

RICHARD KROLAK

BOB PALMER

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BE IT REMEMBERED that on Wednesday, October 10, 2005, commencing at the hour of 10:09 a.m., at California State University, Residence Dining Facility, 5241 North Maple Avenue, Fresno, California, before me, DANIEL P. FELDHAUS, CSR 6949, RDR, CRR, in the state of California, the following proceedings were held:

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(Mr. Pringle and Mr. Cappitelli were absent from the meeting room.)

CHAIR PARSKY: Good morning, everyone. I want to welcome our audience and everyone to the eighth meeting of the Post-Employment Benefits Commission.

I want to thank Cal State for hosting us today and welcoming us onto the campus.

And I think we've said at every meeting, but I want to make sure that people in the Central Valley understand as well that we're holding our hearings around the state in order both to learn from experts, make sure that the public understands what the Commission -- its objectives are, hear from the public, and let the public understand how the Commission is discussing the various options as we move forward to try to make recommendations.

Just a few administrative matters that I want to make sure we cover now.

Our next meeting, our next hearing will be November the 2nd in Oakland, at the City Hall. Then we'll have a meeting on November 13 in Sacramento at CalPERS headquarters. And at each of these meetings, as you will see today, we are going to discuss an overall concept and then a series of issues, and see how the Commission feels about recommendations relating to them.

And if we can complete our discussions at each of the three hearings -- this hearing and the next two -- we may not need to have an interim hearing. And our final one would be December 13.

If we feel we need another session, we reserve tentatively either November 30 or December 7. We have tried very hard to make sure all Commissioners could be at every meeting. And I know that those two dates pose a problem for different commissioners.

So if we can complete our work, we won't need that hearing, and we'll move right to December 13th. But we'll just kind of -- let's stay alert to how we do. That may motivate everybody to move this hearing along as efficiently as possible.

Before we turn to the public comment, a couple more things I'd just want to make sure. I have indicated this in every hearing throughout the state, and I just want to repeat it here for all of you from this area.

The purpose of the Commission is to identify the amount of post-retirement pension and health-care liability for California, to evaluate approaches for addressing unfunded obligations, and to propose a plan or plans to try to address them.

The Governor and the Legislature appointed this commission in a bipartisan way, and made it clear that promised pension and health-care benefits to existing state employees and retirees will be met. A number of members of the public in our initial hearings came forward and indicated, "Don't take our benefits away." And so I want to remind everyone that as a condition to proceeding, both the Governor and the Legislature made it clear that the promises would be met.

Part of our job is to try to put forward to the policymakers how this can be done in a fiscally responsible way.

Just a little bit of a change in the agenda. Also, we're going to have, as always, a public comment period. But then instead of having our report first, I think we're going to try to move right into our discussion of the issues. A few commissioners, I think, wanted to make sure that we covered all of the issues. They might not be able to stay for the entire session. We'll see how efficient we are. We may be able to conclude a little bit earlier than was on the agenda. If that's okay with everyone, that's the way we will proceed this morning.

Anne, do you have anything that you'd like to say?

MS. SHEEHAN: I do, yes. Just a couple of things.

As some of you know, we are going back to the initial request to the actuaries to do some more sensitivity analysis. And I know we're having discussions on that. We had had a whole host of issues that we had requested. But we had to scale it back just because of the cost of the various ones. So we're going to hone in on that. That would be really useful to the Commission in terms of their recommendations.

The second issue is that we are continuing to survey locals.

The counties actually win the prize. We've heard from every single county on their unfunded.

The cities we are still working with, special districts also, and the school districts have been really the most challenging. So I know I've talked to some of you about -- we've identified the school districts with revenues in excess of $100 million. Those are the ones that need to report according to the time frame that we can get information. So I will be continuing to contact those of you who could lend some assistance to trying to get some of those numbers.

I don't know if Steve Keil is here, but I do have to thank Steve Keil -- yes, he is here -- for his help with the counties. And I know Dwight Stenbakken has been very helpful with the cities and is continuing to help us.

And then the only other announcement I have -- and I know some of you are very aware of this -- is the Governor did sign AB 554 the other day, that would allow PERS to set up trust funds for non-PEMHCA agencies to fund their OPEB liabilities.

We heard a great deal about this at previous hearings.

CHAIR PARSKY: We did.

MS. SHEEHAN: And they did go ahead and sign those. So, yes, they can begin in January.

And that is it.

CHAIR PARSKY: To the extent that the commentary we heard helped him make his decision, that's fine. Otherwise, we're delighted to hear that.

Okay, do any Commissioners have anything they would like to add?

(No response was heard)

CHAIR PARSKY: Okay, then let's move into our public comment period.

We have four speakers signed up.

Fran Blackney, Irene Ransom, Stanley McDivitt, and Dave Kehler.

Fran Blackney.

MS. BLACKNEY: My name is Fran Blackney. I'm with the California Foundation for Fiscal Responsibility, which I'm sure you've all heard of.

The Fresno County Grand Jury report for 2006 opened its report on pensions with this sentence: "The Fresno County retirement plan is an employee's dream and an employer's nightmare." And that's what I'm here to talk about, is the expense of pensions and a possible solution for new hires several years down the road.

Since 1980, the County has had to borrow three times to cover the pension obligations. As of December 15th, 2005, the County's bond indebtedness was a whopping $1.18 billion. This indebtedness amounts to $1,361 per person living in Fresno County.

Over the past eight years, Fresno County has gone from zero pension debt, to a principal debt of $545 million.

One of the recommendations of the Grand Jury report was that the Board of Supervisors must actively support legislation that will modify retirement benefits.

California pensions for public workers are an out-of-control train, steaming down the tracks with us poor taxpayers tied down in front of it.

I'm a proud member of the California Foundation for Fiscal Responsibility. I'm here to tell you, if significant pension reform is not done, it's the ultimate in fiscal irresponsibility.

In today's Sacramento Bee, there was a large article that the revenues to the state are starting to decline at a faster rate than they had anticipated, which is going to further increase our debt.

California offers the most generous pensions in the country, and we simply cannot continue on the same track that we are right now. Cost to the public to fund these programs have skyrocketed from $160 million in 2000, to $2.7 billion this year. We can't afford to keep funding these and fund our schools and our transportation and our water problems. There's just not enough money to go around.

The California Foundation for Fiscal Responsibility has created an initiative that will reform the state pension program while keeping it generous for the state workers.

The premise is very simple: For those hired after 2009 -- and again, we're not talking about current workers, we're talking about those hired after 2009 -- it will continue the defined benefit program for the workers.

However, the retirement age will revert to what it was several years ago, 55 for public safety workers and 65 for miscellaneous workers, just as it is on the private side.

Because these workers will be closer to the age of Medicare coverage, the cost savings is estimated to be $500 billion over 30 years. And that's a lot of extra money that could be used for schools and for transportation in the state.

The lower retirement age is wreaking havoc in many counties. Recently the Fresno Bee had an article that Fresno County has gone through six fire chiefs in the county since 2005, because they get hired and then when they hit age 50, they retire. That's a lot of turnover and it doesn't maintain continuity of work.

Our public workers are needed to keep our state running; but over the past decade, their salaries and benefits have been awarded with little regard to fiscal responsibility.

Deals are made that are untenable. And then when a fiscal crisis hits and we can't keep these deals, they have to come back to us taxpayers to pay for it. Therefore, I'm urging you to consider the Public Employees Benefits Reform Act as a commonsense way that is beneficial to private workers as well as the public workers.

Thank you.

CHAIR PARSKY: Thank you very much.

Irene Ransom.

MS. RANSOM: Good morning and welcome to Fresno.

I am Irene Ransom, and I worked as a classified employee for 28-plus years. And I plan to retire from College of the Sequoias in December of this year, in 2007, with 24-plus years of service credit.

I am happy to be able to make the decision to retire at this time. I have plans to do those things that have been on my wish or dream list to do, like to go on a glider plane ride, take a hot-air balloon ride, do my gardening, organize my garage so it's nice and neat and I can find things in there.

Also, I'd like to be able to plan day trips with my family, go to the mountains, go to the coast. Just spend time with grandchildren.

Between my husband and I, we have 18 grandchildren, and they vary from California to

Tennessee. So we're going to have a lot of planning and day trips. Plus, I plan to work with my son on a part-time basis.

Being a PERS member for all those years has allowed me to make this decision at this stage in my life while I can still do some of those things that are on my dream and wish list.

But with retirement comes worries, concerns for me. I'm not rich, but I have a spouse still working. I'm going to be able to be comfortable in my retirement.

Unless things change -- and I'm sure sometimes something will change for my life, for life continues to happen.

I'm healthy now. As time goes -- at this time in my life, I do not take any medicine; but how long will that last?

I will never see an increase in my income; and I'm sure that the cost of living will continue to rise. Housing and groceries consume about 30 percent of my retirement income now.

But what will it be in five years from now and further on down the road?

Health care is a really big issue. My employer and my government have promised me that as I age, turn 65, health care is a given. But I read in the newspaper all the time about employers and government breaking their promises by changing their priorities due to health-care premium costs. For all of my work in life, my employer has been my priority. All of my adult life, I have been a community activist. I voted, worked to make my corner of the world a little bit better place to live. It seems strange that my golden years will turn out to be my worry years.

I urge you to keep PERS the retirement standard for the working class. Everybody participates in PERS and everybody will benefit at a reasonable expected level.

A few people may be living rich with their PERS dollars, but the majority of us are living in mildly comfortable circumstances and continue to work at keeping what we have: Our health and our limited retirement income.

SB 840 is the way to take care of the health care issue for California.

Thank you for listening to me, and thank you for your time, and have a great day.

CHAIR PARSKY: Thank you very much.

Stanley McDivitt.

MR. McDIVITT: Good morning.

I'm Stanley McDivitt. I'm the retirement administrator for the City of Fresno Retirement Systems.

As you may note from some of the information you received, we actually have the two highest funded pension systems in the state of California. And we're very proud of that.

And I've looked at your past agendas so I'm going to limit my comments to our system and what we've done differently.

As I looked at the history of the systems at the City of Fresno, there were four things that jumped out at me.

One, we started an amortization in the early 1970s of our unfunded pension costs. That was typical of most systems throughout the state.

In 1974, we added equities -- or started to add equities to the portfolio. It was an all-bond portfolio prior to that.

And then in 1993, I was following, in my role as the treasury manager, division head for the City as well as administrator of pension systems, I did a lot of bond underwritings for the systems and came into interaction with bond underwriters. The County of Sonoma was doing the first pension obligation bond in the state. And we followed behind that as the first city to issue pension obligation bonds in March 1994.

That was an interesting process that I'd just like to share a second with you.

We did our due diligence. We took it to the retirement board. We had our actuary analyze this situation. We evaluated the risk of doing a pension obligation bond. We took the issue forward with legal analysis to the council. The council authorized the issuance of $245 million in pension obligation bonds, which would fully fund both retirement systems in 1994. The critical time there is the timing of the markets. We fully funded the systems. We were able to put the money into the investment market, spread it across our asset allocation and pooled funds initially, and then divested that into separate accounts.

We followed that with investment returns of 19.6, 19 percent, 17.9, 20.2, 12.7, 11.6, which was the year 2000. And then the correction hit. We had a negative 4.1, a negative 5.8, and then in 2003, the markets turned again back positive: 4.31 positive, and then four years of double digits: 17.7, 10.94, 12.12, 17.36.

What does that mean? Well, if you annualize that over 15 years, it's 10.88 percent. With a target of most pension systems, you can see how we became funded. And if you understand simple finance, when you compound early, you're very successful.

And that's really what this is all about. We've been able to compound our investment earnings early on. We remain fully funded.

Now, in 1998, this is what we've done different, and this is the important part of my comments today. In 1998, we were actually approximately 185 percent funded on a market-value basis. Actuarially, it was about 165. We were heavily funded. And there was lots of words: overfunded, superfunded. You can discuss all of the verbs for it. But the bottom line is, we did something different that the other systems in the state did not do.

We had a direction from our City Council to look at what we could do to assist our retirees in their post-retirement health needs. The retirement boards looked at the options and came back with a recommendation. And this was a recommendation that's very unique. We came back with a concept that we needed an incentive to keep the surplus in place rather than everybody fighting over the surplus. So we did it differently. We created something called the "post-retirement supplemental benefit." Now, that sounds good. It's surplus-sharing by another name; but in my mind, it's a tri-party agreement.

So what happens in our world? In Fresno, we have, I call it when I do my diagram, it's a triangle. And I'll give you a little handout that I'll distribute to you when I'm done. But it's a triangle. One side is the active employees, one side is the retirees, and one side is the city. And we created incentives for every party to keep the surplus in place.

(Mr. Cappitelli and Mr. Pringle entered the meeting room.)

MR. McDIVITT: And how did we do that? Well, we paid one side, we pay a benefit contingent upon the availability of surplus to retirees. We also distribute money into a surplus reserve that offsets the City's contributions to the degree funds are available. And we also offset the COLA portion of the active employees' contributions in the employees' system. In the fire and police system, the City pays the COLA so there's no offset there.

What did we create? We created something for everyone to have an incentive to keep the surplus. And if you understand finance, when you're in a surplus position, the compound growth is phenomenal.

My employee system has not contributed -- or excuse me, the City has not contributed into the employee system since 1997.

We just did a surplus projection report. We have projected out through 2013 that there won't be contributions if –- caveat -- if we maintain our assumed actuarial returns.

That's the value. We’re in essence a big insurance trust. We're overfunded, and we can cover the cost of the City.

The fire and police system has a $4 million contribution in FY07. Why? Because they've added a lot of public safety positions to the budget.

The concept wasn't designed to absorb ongoing positions.

We've done a projection with growth to 2013. The City will have added 1,200 positions from 1997 to that year. And in the employee system, it’s been able to cover pushing 400 new positions. In the safety system, the rate turned on a little bit. Why? Because we're funding a lot of new positions. That is not a problem. That is a good thing. So we've been very successful.

Also in 1998, the second part of what I think is important in '98 is, we created a deferred retirement option program. It's a DROP program. We've spent a lot of time working with our actuaries on this, and we designed it to be cost-neutral. We have back-tested it. It's not only cost-neutral, it actually contributed to the surplus of our system.

And the question is why? And I realize DROP programs have had a lot of bad reps throughout the country in certain locations, and the main reason is the city or the county or the state quit funding them during the amortization time that they're in the DROP program.

Our City continues to contribute while the members are in the DROP program, and our members share in investment risk. We use a five-year moving average. Now, net of investment expenses credited to their DROP accounts. That rate's been double-digits, it's been as low as 2.81 percent. So the members share in the investment risk.

So, in essence, what have we created in our DROP program? A cost-neutral program, members share in the risk. We’ve created a hybrid program.

Members have ownership of their DROP accounts, that will actually pass to their estate if there are no beneficiaries. So we've created something that resembles a 401(k) for a portion of the retirement benefit. This is done on a very actuarial basis. We've had it reviewed by our actuary and we've had it certified that it is cost-neutral.

So we believe we've done things right in the City of Fresno. And we have thought about these things hard. I don't know if it can be done in other places. But we did it carefully and we did it with the idea that there's a benefit out there.

So we didn't go back retroactive and enhance benefits, like many of the entities did throughout the state, the counties, and other cities. However, by use of our post-retirement supplemental benefit dollars, our DROP program, my Tier 1 members have received the equivalent of a 3 percent-at-50 for their career. So there are other ways of achieving objectives here if you sit and think about alternatives.

We think we've created some alternatives. We think we’ve created some hybrid concepts, and we're quite proud of those at the City of Fresno.

So in summary, we are what we believe to be the highest funded systems in the state. We pay out post-retirement supplemental benefits to our retirees. Currently, the amount for the fire and police system is $326.32 a month, and the other system is $214.98. This helps subsidize it. They've been higher in the past. The surplus projection report projects those numbers going up over time.

That concludes my remarks. I'd be happy to answer any questions that the Commission may have.

CHAIR PARSKY: Thank you very much.

DR. GHILARDUCCI: Just one question. Are your retirees in your active plan, health insurance plan, do they stay in the plan and then you just help them pay for the premiums?

MR. McDIVITT: Yes, just a comment. Both of our systems are non-Social Security systems, by the way. And the members have the option of staying in the City of Fresno Health and Welfare Trust at their cost.

DR. GHILARDUCCI: At their cost, but they get that supplement?

MR. MCDIVITT: They get the PR –- post-retirement -- supplement, but they pay the full cost of the Health and Welfare Plan.

DR. GHILARDUCCI: Okay.

MR. McDIVITT: We do not control that. The trust does.

DR. GHILARDUCCI: Now, you said that you contribute to help fund the DROP program. But I thought you said you haven't been contributing because of your superior returns?

MR. McDIVITT: Yes.

DR. GHILARDUCCI: Maybe I misheard.

MR. McDIVITT: Yes, that's an actuarial concept. In essence, the City is charged the equivalent of what the normal contribution is.

DR. GHILARDUCCI: Got it.

MR. McDIVITT: If they do not have enough money in the City's surplus reserve from the allocations annually, then they have to contribute cash, the City would.

DR. GHILARDUCCI: But so far, you have had enough in that surplus account?

MR. McDIVITT: We have in the employees' system.

The fire and police system, as I mentioned, the City now makes -- in '07, they made a $4 million contribution.

The citywide normal contributions are $28 million. $4 million is the only amount the City pays.

DR. GHILARDUCCI: Okay, and just about your OPEB -- not your OPEB, sorry -- the obligation bonds.

MR. McDIVITT: Yes.

DR. GHILARDUCCI: Who pays the bondholders? The pension system or the city?

MR. McDIVITT: The City pays the bondholders. Remember, it was $245 million. I actually don't know the balance of it. It's been refinanced twice, with lower interest rates, and actually it's spread out on a flat -- it was originally structured to look like the payments to the pension system, and they set it up to look more like a mortgage so they could budgetarily handle it better.

The City, if you'd like to know the answer, has received about $250 million in surplus credits to this date. We project it through 2013 to be $410 million.

This is money that has remained within the City operations and funded positions, whatever they've chose to spend it on.

DR. GHILARDUCCI: Just one last question. Did you have anything to say to the previous testifier, the first one?

Was she talking about the City of Fresno --

MR. McDIVITT: She was talking about the County of Fresno.

DR. GHILARDUCCI: -- or the county?

Talking about the county. Okay, thank you. That was really good testimony.

MR. McDIVITT: Thank you.

MR. COTTINGHAM: I was wondering what decision-making process did you use or approval process to bring in your DROP program?

MR. McDIVITT: Well, again, the DROP program actually came through the retirement board as a concept. The labor unions did a meet-and-confer with the City, but it was contingent upon designing a cost-neutral program.

And, again, we went back through DROP programs throughout the country. We looked at them all and then we challenged our actuary to come up with a cost-neutral concept.

And as I said before, the cost-neutral requirement is, most pension systems, depending upon which funding method they're on, they're amortizing the City's costs over a period of time. And if you shorten that, you haven't paid in the amount.

Many DROP programs throughout the country stop their city, state, county contribution, which creates a negative situation in the DROP program. They do it to save money, all right, it's a political concept.

However, our City was willing to take this program as an incentive to retain. What you have to remember is in the City of Fresno we've hired a lot of safety people. And there was a dramatic need to maintain the existing base of people to transition and partner share with all those new safety officers. It was a critical need at the City.

We do have a DROP program, by the way, in both systems. We may be the only one in the state, I'm not sure, that has that.

But, anyway, we went through a step-by-step analysis with our actuary. We wanted to have a great

DROP program but we wanted it to be cost-neutral. And that was the basis.

We even have an interest-crediting method that if the DROP program is not cost-neutral, we can reduce the crediting to the DROP accounts up to 300 basis points to maintain cost-neutrality.

We have thought about this very hard, and we think it's critical that the DROP program maintain the cost-neutrality.

MR. COTTINGHAM: Have you looked at how it has affected your ability to retain city employees, and maybe specifically in your area of safety that you said you were concerned about, and so have you been able to look at possibly the effect on disability retirements?

MR. McDIVITT: Well, the first issue is retention. We find in the safety system that most members spend somewhere in the neighborhood of four and a half to five years in the DROP program. And we think that based on past experience, that has lengthened participation in the City employment. There are a few that stay up until ten years in our DROP program. That's the maximum period of time.

But in general, we think it has lengthened it by two to three years of what was previously the average retirement.

From an incentive basis, there is motivation. The DROP program does provide a motivation to membership.

As far as a disability or an injury base, our provisions allow the tax-free status to pass on a disability, even though you're in the DROP program.

There are some DROP programs that revert you back as though you've never participated in DROP. Ours does.

To me, the incentive -- there isn't an incentive to stay in DROP and have disability. Our experience is, there's a risk -– this is just an actuarial statement from me -- there's a risk as you work longer in public safety, there's a risk of disability just by simple age and the factors that, you know, you're out there in the field working. We haven't necessarily seen the number of -- in my office, we haven't seen the number of claims going up significantly just because of the DROP program.

And again, it's only -- I think it's only two or three years longer of employment. So it's not like they're working ten years longer. There are some that do that, but on average, we're not seeing that experience.

MR. COTTINGHAM: You're saying you haven't seen them rise, but have they stayed at a steady rate then? Or have they lowered it?

MR. McDIVITT: No, I wouldn't say they've lowered. Well, again, you have to take this with a grain of salt. The numbers of our officers have dramatically risen since 1996. We had a tremendous increase from federal grants, we had the reduction of the pension contribution. We've seen hundreds of new officers at the City of Fresno. So from that perspective, we have cycles going on and we have different life cycles of the membership.

We have a second tier that was created in 1990 which is the predominant employment. Most of our members are in that. There's a couple hundred left in Tier 1, but most of the members, probably 800 of them are in Tier 2 now. So you can see the additions there has been since 1990. So it's difficult to answer your question directly because a lot of our people haven't achieved the disability status. We're still out there with a lot of the employment. So you're going back really to our Tier 1 people to get a real history of disability.

MR. COTTINGHAM: And the concept of when they go into the DROP, they basically -- it's a contract that they will stay X-number of years.

Has that helped in basically succession planning or with the City knowing when you're going to have a group of employees leaving, or in what positions they are?

MR. McDIVITT: Yes, absolutely. That's been one of the important things.

As I said before, one of the big problems we encountered immediately, especially in the safety side, was hundreds of new officers, both fire and police out in the field. And we really needed the expertise of the long-term employees to stay with them and do a transition.

As to management, we do usually get notification. There is -- I don't know if it's an honor thing, but we get a lot of pre-advanced notice from our members when they're going to retire. And because of that, police and fire departments have been at an advantage in my opinion to plan for these transitions and structure within their organization. I think it's been helpful.

MR. COTTINGHAM: Okay, thank you.

CHAIR PARSKY: Connie?

MS. CONWAY: I'm sorry, thank you.

I had a quick question about the DROP program. I think it was in the late nineties or early -- actually, late nineties, a firm that I did some work for your workers' compensation disability management program.

So you don't believe that the DROP program, the tax-exempt status of the disability or the work-comp injury at the end of that DROP program didn't incent?

MR. McDIVITT: That incentive was there without the DROP program.

MS. CONWAY: Okay.

MR. McDIVITT: I don’t believe that’s an honest statement. My comment is -- and this is a potential risk -- is that the members are working slightly longer. And they're in a dangerous field, public safety. So there is a risk of injury at an older age. That, I think, no one can argue that. However, I don't think the incentive is any different at the time of retirement with or without DROP, for the tax reasons or the tax status.

MS. CONWAY: Okay.

CHAIR PARSKY: Thank you very much. We really appreciate your presentation and your willingness to respond.

MR. McDIVITT: Thank you very much.

CHAIR PARSKY: Dave Kehler.

MR. KEHLER: Good morning. My name is Dave Kehler. I’m with the --

CHAIR PARSKY: Oh, “Kee-ler”? Sorry.

MR. KEHLER: That's quite all right, Chair Parsky.

I'm the retirement plan administrator for the

Tulare Employees Retirement Association. And like Mr. McDivitt, I would like to spend just a few moments introducing our plan to you and some of the methods that we have followed and successes that we have had in funding our retirement plan.

The Tulare County Employees Retirement Association is a county retirement plan that was established under the County Employees Retirement Law of 1937. We are one of the 20 '37 Act counties that exist in this state.

Our system is one of the smaller plans. We have currently approximately $1.1 billion in total assets and slightly less than 8,000 total members of the retirement plan.

But our smaller size does not necessarily equate to the strength of our overall program. I was informed yesterday by our actuary that as of June 30, 2007, our funded status is 94.5 percent, which is up from 92.1 percent for this current year.

So we're seeing some good funded status that has come out of the plan. And in part, that's due -- in fact, in large part -- by the investment performance of our investment portfolio.

Over the last ten years, we've added over $888 million in assets to the plan. 77 percent of that has come from investment performance and investment income.

If you add the contributions made by plan members themselves out of their own pay, then 89 percent of the asset gains are accounted for by investment income and by contributions made by the plan members themselves.

So we feel that we have a plan that is very well funded, that's established to be able to meet the needs of our plan members, and to do so at a cost that is relatively low for our plan sponsors and taxpayers.

That's not to say that the plan sponsors don't play an important role. In fact, they do. But our contribution rate currently for our plan sponsors are at a level of 10.8 percent. And that's going to drop to 9.8 percent beginning with the next fiscal year. So good news for Commissioner and Supervisor Conway.

We think, too, that part of this, as I mentioned already, has to do with the investment portfolio that the board of trustees has adopted in Tulare County. The rates of return have been excellent for our plan over the last decade. In fact, for the period ending June 30, 2007, the one-year return was 18.7 percent; and over the last ten years, 10.5 percent. And that takes into account the end of 1990s, where we had the end of the bull market in equities. It takes into account the years 2001, 2002, and 2003, in which our returns were either negative or less than expected, but it also takes into account the return of good, healthy markets that have seen us be able to build an investment portfolio and returns that meet the needs of our plan members.

I think Mr. McDivitt covered quite a bit of the ground that I would like to cover, basically indicating to you that there are different methods in which plans can meet the needs of the local entities and of their plan members. And so rather than repeating a lot of what he said, I would just like to leave you with the fact that our concerns, as a plan, especially in light of the subheading that you have today, looking at local issues, is that the Commission take a close look at some of those plans that have been successful in meeting the needs of our plan members and our taxpayers. We think that Tulare County Employees Retirement Association, along with the City of Fresno, are two Central Valley systems that are well on their way to meeting those obligations.

We look forward to being able to do so in the future. And we would so ask that you give strong consideration to what we've been able to accomplish, in comparison to some of the concerns that are expressed that maybe a one-size or one-plan system is needed for the entire state. We disagree. We feel that local issues, local policymakers, and local control is what's needed in order to meet the needs of Tulare County, the City of Fresno, the City and County of San Francisco, and throughout the state of our public employees and their beneficiaries.

I am more than happy to answer any questions that you might have regarding our particular plan and what we've been able to accomplish. And if there is anything that we can do to make your job a little bit easier and help you reach the goals that you've set before yourselves, then please feel free to contact us. We'd be happy to be of service to you.

CHAIR PARSKY: Thank you very much.

The last speaker will be Kevin Smith.

MR. SMITH: Good morning. My name is Kevin Smith. I'm with SEIU Local 521 in Fresno. I would like to welcome to you Fresno and thank you for giving the Central Valley this opportunity.

I'm here to read a testimony from one of our members who is out with a family emergency right now and was unable to come, so I'm here to read it for him. His name is James Hackett.

"I've worked with Fresno County for 17 years

and I'm a member of SEIU Local 521. Fresno County employees, like all public employees around the state, have dedicated their working lives to providing critical public services to the residents of California. Our benefits are modest; and after a lifetime of public service, we are fortunate to have some security in our retirement. Even so, with rising housing costs and other cost of living, many retirees still struggle to achieve a secure retirement. That said, the benefits we receive not only support our retirement, a recent study of the economic contributions retirees make to the community shows that our benefits contribute to the economic growth of the county overall.

"According to a recent study, Fresno County retirees contribute over $200 million in direct and indirect economic activity in Fresno County. This support is critical to supporting our local small and family businesses.

"We are proud that our work providing services to the public and our continued financial support to the local economy is helping make this a better place to live.

"Fresno County employees know that good management and real oversight over our pension system is crucial to protect our employee pensions and ensure

pensions are cost-effective for employers and employees. Therefore, I'm here to support the adoption of best practices by the PEB Commission to provide guidance to the public agencies on those best practices on which agreement can be reached.

"Possibilities could include, but are not limited to, sound actuarial assumptions for determining OPEB cost, prefunding best practices for those agencies that decide to prefund, and establishing a panel of actuaries to provide advice or recommendations or other practices that provide information, processes, or procedures to stabilize the cost of pensions and retiree benefits."

Thank you.

CHAIR PARSKY: Thank you very much.

That concludes our public comment period. And now I'd like to turn to the agenda that was scheduled for the afternoon, which is our discussion of our first concept.

Just to remind everyone on the approach that we agreed to take to try to move toward final recommendations that would be included in our report, we've divided the program into three concepts. And each of the hearings -- this one and the next two will be dedicated to one of those three concepts.

And the concept for discussion here, broadly speaking, is: *“A competitive, affordable benefits package serves the public good by enabling public employees to recruit and retain qualified employees*.”

That's an interesting process.

Tom, would you rather be there than up on this –- is that okay? If you want that podium back, you can have it.

MR. BRANAN: No. I'm just glad I wasn't standing there.

CHAIR PARSKY: I think you would have been moved with it.

Anyway, that's our first discussion, the first concept.

Within that concept, we've agreed that there would be six subject matters that we would discuss today. And in that connection, then see if we couldn't come up with some recommendations relating to each. So what I thought we would do is to take them one at a time, let Tom kind of give the -- you've been provided with a background piece on each of the subjects.

Tom will remind us just briefly about each of the subject matters. And then so we can move the discussion along, we'll put up on the screen some possible recommendations that everyone can then discuss.

We'll try to do this in the most efficient way possible.

So Tom and Stephanie -- Tom, why don't we start with the first subject, *"Actuarial Design, Proportionate Benefit Design"* and give a little bit of background, and then we'll see if there are any questions about the background, and then we'll put up in draft form some possible recommendations.

MR. BRANAN: Mr. Chair, Commissioners, before we do that, I would like to do a little bit of housekeeping, and that is, at our last hearing, members of the Commission expressed the desire that we have fewer speakers but that we have area experts available in the audience so that they could address your questions. And we do, indeed, have experts today. Some of them you know. I think perhaps one you don't.

We have Bob Palmer on this end.

Dave Christianson, who is new to our staff.

Richard Krolak, that you saw speak on health care.

And we have Grant Boyken, also. You've seen him, and he's available today as well.

And they have directions that if Stephanie and I say something that is totally outrageous, they are to drag us away from the microphone and make a correction. So if you see that, you know it's planned.

CHAIR PARSKY: We can eliminate “totally.” If you just say anything outrageous.

MR. BRANAN: Okay. Well, maybe I should stop.

We called this originally "Actuarial Equivalency" because that is the term used for pensions. And it was pointed out to us that it can't be really transferred to health care. So you'll see there in parens, "Proportional Benefit Design."

The idea is, as with pensions, that person's benefit grows with age. So the longer they stay, the bigger their benefit. And if a person leaves early, they get a proportionately smaller benefit. But the idea is, the benefit grows with time on the job.

What we are proposing here is that you look at the accrual of health care in a similar vein so that the longer you're on the job, the larger benefit you will earn. And that really is it, in a nutshell. We’re looking at –- well, that's it. We'll see what you have for questions.

CHAIR PARSKY: And I think you see up on the screen here I guess what might be viewed as two possible recommendations.

Is that right?

MR. BRANAN: No. Those are background. But we could have the recommendations.

CHAIR PARSKY: Potential recommendations, is that --

MR. BRANAN: Okay, the "Potential Finding" is that methodology and funding of public pensions complies with the requirements of actuarial equivalency and encourages public employees to work longer.

And this is not the case with the current method of providing retiree health care in many agencies, where many public employees can earn lifetime health care after five years of service.

Now, I should point out that five years is a threshold where you gain access to the health care. It doesn't really commit the employer to a particular amount. That's dealt with differently. But it's this notion of threshold so that -- and could we have the next?

So the idea is that the recommendation would be that health care should be earned in a proportionate manner as is a pension benefit.

CHAIR PARSKY: Why don't you just read each of the two, and then we can step back?

Again, these are just draft, for discussion purposes. But let's see if there are questions about the background, if there are questions about how we would move in this direction.

MR. BRANAN: Okay.

CHAIR PARSKY: Go ahead.

MR. BRANAN: Number 1: For the purposes of service retirement only, the threshold for the years of employment required to access an employer's health plan risk pool should be proportionate to the number of years of employment and should reward longer careers.

For example, this change should result in a period longer than the five-year requirement currently used by many agencies.

Number 2: For the purposes of service retirement only, the amount of the employer contribution, if any, to retiree health care should be proportionate to the number of years of employment and should reward longer careers.

An example of that is the current state-vesting level for PEMHCA health care. And that is, once an employee has worked ten years, they qualify for 50 percent of the employer contribution. And it goes up annually so that a person who stays 20 years gets 100 percent of the employer contribution.

CHAIR PARSKY: Once again, I know this material wasn't provided in advance. This is all meant to be for discussion. If the concepts are concepts that the Commissioners think should be incorporated in draft recommendations, they will be circulated and people will have a chance, but conceptually --

DR. GHILARDUCCI: We don't have that.

CHAIR PARSKY: You have the background.

DR. GHILARDUCCI: Right, we have that, but we don’t have that.

CHAIR PARSKY: You don't have the staff's recommendations. So let's first start background-wise. Is the concept we're talking about here or the subject matter understood by the Commissioners? Do you want to ask the staff or any of the experts about -- the subject itself we talked about including, but we want to make sure that everyone understands from a background standpoint then we can move to what may be findings, then we can move to what may be recommendations, all of which is open for discussion.

Yes, Lee?

MR. LIPPS: Tom, I just have a clarification question, because you're using two concepts interchangeably: Years of service and age, which could be two different concepts in the sense that if somebody comes to work for a state agency and begins accruing a benefit, say, after another career -- so, you know, and they don't start until they're 45 -- then they have, under this concept, they have to work another 20 years in order to get access to retiree health.

Did you see any kind of play-off or interplay between those two concepts?

MR. BRANAN: Age shouldn't have been mentioned. This is based on years of service. Obviously, with pensions, your age and your years of service can increase your benefit. But what we're talking about here is based on years of service.

MR. LIPPS: Thank you.

CHAIR PARSKY: Yes?

MR. CAPPITELLI: Just a quick question. Is there an incremental change between, say, the ten years of service and the twenty years of service? In other words, does it start at 50 percent and then at 11 years go to 60, 12, 13, et cetera? Or is it --

MR. BRANAN: Yes.

MR. CAPPITELLI: Okay, so it's a sliding scale?

MR. BRANAN: Yes, it's a sliding scale.

MR. CAPPITELLI: It’s gradual? Okay.

MR. BRANAN: And you've got, what is it, 5 percent a year.

MR. CAPPITELLI: 5 percent a year? Okay, thank you.

CHAIR PARSKY: Curt?

MR. PRINGLE: Yes, could you go back to the previous slide, which is the Potential Finding?

CHAIR PARSKY: And, again, don't focus too heavily on the exact wording, because the wording could obviously be changed. But the concept is what we're trying to advance and get people's views on.

MR. PRINGLE: Okay, I guess there's the proper cautionary element. I mean, the assumption here is that health benefits would be a contributor, and health retiree benefits. Setting this up this way basically says that is an important encouragement to employees for longer time in service. Therefore, we would be making -- presenting a public policy position by supporting this that says we think that is an important move and a critical move for employers to provide some post-employment health benefit. That is the assumption I read from this.

Is that the assumption which we're trying to promote?

MR. BRANAN: Yes, and I think at least anecdotally, PERS has interviewed retirees and found that, to many of them, their health-care benefit in retirement is actually worth more to them than their pension.

And on one other point there, we're not saying that if an employer doesn't provide health care, that the recommendation is that they have to. But if, for those employers who do provide it, they should look at this graduated approach.

MR. PRINGLE: So I see where you're going on this. I probably have a concern -- and I'm not going to be tweaking language now, I'll be glad to wait and have that discussion later. I do believe that this, though, presents this public impression that, in fact, we are taking a position to promote post-employment health benefits; and we think that, therefore, the next step, which is the recommendations, greater benefits for greater longevity of service, and that's how we're addressing it.

MR. BRANAN: I don't think that's really what we're proposing. We're saying that if an employer provides it, they should consider something other than lifetime health care for five years.

MR. PRINGLE: Yes, I see that that's where you're getting to. But I just will offer a concern that the way this finding is presented, it sounds like, in an equivalency context, we are trying to argue that a lifetime retirement benefit, the same degree of encouragement that employers to provide a continuing post-employment health benefit, is an important thing to do, as opposed to what you just said, to ensure that there is a balancing of what that benefit is if, in fact, the employer chooses that.

So using this as a finding, I hope you hear my concern and caution in that; and then on the next slide, I think it kind of reiterates that point, as opposed to making the specific point you did that, clearly, there should be a matching of time and service to that ultimate benefit, if, in fact, that is the choice of the employer. Because who are you really talking to in Number 2? I mean, so the state of California does offer that; right?

MR. BRANAN: The state does. But within the PERS health-care program, there are 1,082 agencies that still have five-year.

CHAIR PARSKY: And to some extent, Tom, I think what you're -- this is driving at what is fiscally responsible, affordable. It's more along those lines, without imposing on the employer to do it. It's more of a recommendation that relates to balancing what is provided on the health care with what is provided on the pension.

DR. GHILARDUCCI: Uh-huh.

MR. PRINGLE: So for me, who sat through a number of these meetings and being confused on what we are saying, I'm just suggesting that those who may not be as knowledgeable as every member on this board, with the exception of me, because most people are at that degree, that we should try to make it more clear as to what that point is.

And I think your point is that 100 percent after a minimum number of years of service does not justify 100 percent full coverage for a lifetime, is what you're saying. So, I mean, I would much rather hear those points more specifically.

CHAIR PARSKY: And, again, the whole purpose here is to get input from the Commissioners, clarification of how people feel about the recommendations, take the recommendation out. Again, it's all within the broad concept -- remember, the broad concept that we are dealing with, with these six subject matters all has to do with the fact that we think that a competitive, affordable benefits package serves the public good by enabling public employees to recruit and retain qualified employees. That's the broad concept.

Within that, the first subject matter of this: How do you deal with it in a responsible way? How do people feel about that? And we want to kind of try to go through those. And getting input like this is just what we want.

Lee, you have another comment.

MR. LIPPS: It's just that I thought that

Curt's reading a little bit too much into it. The words, “if any” up there on the employer contribution, I think fairly clearly indicate it's for those who choose to provide either a medical benefit -- a retiree medical benefit up to the age of 65 or something for lifetime. I don't automatically read "lifetime benefits" in there.

One of the points that I made in the memo that I sent for the Commissioners on this point was that whatever kind of modification that a local agency -- and I'm thinking now local as opposed to state -- a local agency wants to make along these lines, it needs to come through the collective bargaining process where there is a collective bargaining relationship. That if -- you know, it should be a local decision.

CHAIR PARSKY: Right.

MR. LIPPS: Whether to move to a system like this, we have some school districts, for example, that provide a lifetime medical benefit after a two-year vesting period.

If it's something they want to move out into something else because of the drain on its local budget, they should be able to discuss it. But it should be clear, at least for local agencies, that it's a locally determined matter as a matter of their compensation priorities and that it be collectively bargained.

CHAIR PARSKY: And I think what we've said in the past is that any of our recommendations will be prefaced by not attempting in any way to remove from what is appropriate for the collective bargaining process the recommendations themselves. So that we will make clear.

Dave?

MR. LOW: Yes, I just want to amplify a little bit on that because, you know, what is affordable and what is fiscally responsible is going to vary agency by agency.

And a couple of things that I see left out of this discussion is, in addition to the various vesting schedules they have for retiree health care, you also have a very large number of public agencies that offer no retiree health care.

MR. BRANAN: That's correct.

MR. LOW: And it's important that we keep that in context that we're not operating only in a system of people that provide a vesting schedule like the state employees who are at five-year. There's a variety in between, and then there are a large number of agencies of public employees that, when they retire, they get nothing, they're 100 percent on their own.

Also, as you propose this schedule -- for example, the state schedule -- if a group is at a five-year vesting now, are you proposing this ten-year, 50 percent schedule, and a 20-year full schedule? Or are you proposing just considering a vesting schedule?

MR. BRANAN: Well, we use the state example of ten and 20 just because it's a proven vesting schedule, it's out there. But certainly -- and that's a good point, because right now local agencies can adopt that. But there has been legislation where agencies would want to take, say, a ten-year vesting for 100 percent, or a 15. I think at this point, we haven't gotten to that level of specificity. But I think the recommendation is primarily saying this schedule works for pensions, and it's a good model for health care.

MR. LOW: And are you proposing this for new employees only or for existing employees as well?

MR. BRANAN: Again, I think we would need to see what the Commission is comfortable with.

MR. LOW: I can imagine that somebody -- an existing employee or even a new employee, if you had a five-year vesting schedule now for full benefits and you moved to the state schedule, then you could work another four years and go from getting full benefits, to getting nothing when you retire. If you retire after nine years, you would actually be ineligible for any retirement health care at all. A pretty dramatic cut.

MR. BRANAN: Yes.

MR. LOW: And then what is your response to the whole issue of how these public agencies got to that place where they are now with regard to collective bargaining trade-offs? I mean, how do you take that into consideration if, for example, they decided they could have gotten a retirement benefit formula increasing instead, trading it off to keep their five-year vesting schedule or they took a 5 or 10 percent salary schedule and traded that off? How do you go back and recover that if, you know, you're imposing a new vesting schedule for which they had already traded something off?

MR. BRANAN: Well, first, we're not imposing a new vesting schedule. But I think that you would deal with it at the local level, at the bargaining table, the same way you got to having a five-year schedule.

And you're right, the "what preceded the adoption of health-care benefits or pension benefits," each agency has its own unique history. And I would think that that history would be on the table if an employer wanted to move to this vesting schedule.

MR. LOW: Okay, thank you.

CHAIR PARSKY: Jim?

MR. HARD: Yes, I was just going to respond on the state situation.

And I think absolutely this would be something that would be an issue of bargaining and local history. In the state, it was prospective. You know, nobody got changed from five to 20 years at the time it was adopted. I would think that would be pretty hard, possibly not even legal, in some cases, I don't know.

But I would emphasize, too, that I would think this has to be dealt with by each local entity. And I assume it has also something to do with competitiveness. I assume it has to do with recruiting and retaining the type of employees, and for the terms that you're interested -- the term of work, you know, because some types of jobs, you could have a transition of five years that is practical; but at some levels of training and complexity, that kind of turnover really doesn't work. So I think that has to be part of a local consideration.

CHAIR PARSKY: Well, I think as we take a look at all of these recommendations, I think one overriding principle is one solution, one recommendation doesn't fit all. It has to be decided locally. But I think for the purpose of this Commission, without upsetting the local bargaining process, if there are concepts, principles, recommendations that we believe are fiscally responsible, keying into the overall concept that we want to encourage public employment, that we shouldn't hesitate to send a signal like that. The local authorities are going to have to take that into account in one form or another.

Bob?

MR. WALTON: Thank you.

Part of the difficulty, I think, we're struggling with, is we're getting down to some findings and recommendations. And we may have not focused on what the final report may look like. In my mind's eye, and I'm sure each of us have our own view of what that final report would look like, but it should contain the preface of information, a history before we got the current OPEB benefits to the point they're at today through collective bargaining at the local level, that sort of thing.

CHAIR PARSKY: Sure.

MR. WALTON: That should be a given.

MR. BRANAN: And that is being prepared.

MR. WALTON: Right. The overarching principle, what Dave mentioned about the effect on current employees. We should go back to the Governor's statement, that the promises to current employees and retirees is going to be met, and so there's no intention by this Commission to recommend changing, other than that that's subject to bargaining decisions at the local level. And so I think with that understanding, that may help in going forward and reviewing these recommendations.

Two things about this particular one, Tom.

One, I know later in the vesting, you note the 120-day retirement that PEMHCA has. I think that needs to somehow be included in this portion because it's an important retention aspect that in order to have health benefits into retirement, you must retire from your current employer that's going to provide that.

There's other employers that have it much shorter -- even the next-day requirement. That's not noted. The impression here is that if you work five years, you retain that right forever. That's not true unless --

MR. BRANAN: That's correct.

MR. WALTON: -- you retire from that employer.

The other point that I mentioned before, the term "actuarial equivalency." The current formulas, for the most part, have lost their actuarial equivalency, in my understanding of the term, between early retirement or late retirement. And I think the concept of going back to factors that are truly actuarial equivalents, that are, quote, cost-neutral, if there is such a thing, based on the retirement age, is a concept that I think ought to at least be mentioned, if not recommended by this

Commission. Because otherwise, they don't encourage later retirement or discourage early retirement. They may do the opposite, depending on how those factors are built. And I think that's an important piece to have here.

CHAIR PARSKY: John?

MR. COGAN: So, Tom, the basic purpose of this proposal is to encourage workers to remain on the job longer; right?

I think what Curt said makes a lot of sense to me. It's just not at all clear that if that's our objective, that health care -- changing the health-care benefit as opposed to changing the pension benefit is a more efficient way to go about it.

And I'm wondering if there is some evidence that you have that might suggest that changing the health-care benefit has a bigger bang for the buck than changing a pension benefit?

MR. BRANAN: Well, my expert witness just left the room.

MR. COGAN: He anticipated my question.

MR. BRANAN: I think so.

PERS has conducted at least one survey with its retirees and maybe periodic surveys. And it's been very clear that especially for those people who have smaller pensions, they value the health-care benefit in retirement more than their pension. So if you have to work 20 years and you value that benefit to that degree, then, yes, I think it is a retention tool.

MR. COGAN: And a pretty effective one?

MR. BRANAN: Yes.

MR. COGAN: You know, economics is a science of the eyes and not of the ears. That is, we look at data and try to figure out what people actually do from looking at data rather than from listening to what they say. But it's good that we have some data there.

The other, I guess, point that I want to make here is, as Dave said, we've got a lot of heterogeneity out there ––

MR. BRANAN: Yes.

MR. COGAN: -- among these thousand agencies that are in PERS, in their health-care benefits and their pension benefits. And it just seems to me that sort of a one-size or blanket approach doesn't really make sense. It's not at all clear to me that even though I think it's a good idea to encourage workers to work longer, I am not sure that all of those thousand agencies or districts have retention problems. They might be quite satisfied with the turnover of their employees.

I know with the University of California and at

Stanford, we have exactly the opposite problem. We're offering faculty members buy-outs to get them out. And so it's not at all clear to me that we'd want to impose the same type of policy across all these localities.

MR. BRANAN: I agree completely. And that's why it's a recommendation, not a mandate, and -- go ahead.

MR. COGAN: Right. So one way to come at this, is to, in the report, be thinking about statements like, "Well, if you have a retention problem, if you, the locality, have a retention problem, one way to address that retention problem, and continue to maintain benefits in a fiscally responsible way, perhaps, would be to move to a system, whereby you didn't have five years and 100 percent vesting, but you did a more gradual vesting. It's sort of an "if, then" kind of approach as opposed to a "we recommend" or "we encourage," since maybe any of those jurisdictions don't need that encouragement, they don't have a problem.

MR. BRANAN: Right.

CHAIR PARSKY: I think that those suggestions are very good.

Again, I would hope that we would be able to come up with a recommendation within the concept of proportionate benefit design -- that's the subject matter -- but utilize some of the language that John talked about in order to get to a recommendation. It seems that's a good suggestion.

Matt?

We weren't intending to keep you silent by having only one microphone between the three of you.

MR. BARGER: It's a quiet group down here.

I actually was sort of focused on sort of a slightly different angle that I read into this that maybe that would be different possibly where you were headed. But it struck me that there's sort of two things that go on with the actuarial equivalency.

And the first one actually had to do with the pensions, where I would argue they're not actually all that well designed, because they encourage, you know, people, in a sense, to retire at a fixed point in time. There's no encouragement, at least from the retirement benefits part, to keep working, which might actually be a valuable thing.

So, you know, one of the things that I at least would take away was, you know, pension plans actually aren't all that well designed. So --

MR. BRANAN: That is true, as Bob Walton pointed out. But if you go back to the 2 percent-at-60 formula, which preceded all of the current miscellaneous choices, it really was designed that way.

MR. BARGER: Okay, but let me -- it isn't, at least as I understand it, better, this feeling that you're having a real brain drain, I mean this comment about the fire chiefs retiring at age 50 is an example. So I look at that, you know, with the finding of these are designed well and go, "That's not obvious to me." And a possible recommendation is there are ways to address that issue, to sort of narrowly commute -- add additional credits for staying longer or whatever.

MR. BRANAN: The State Teachers' Retirement System does that. They have longevity awards for people who stay in the classroom and teach beyond the normal retirement age.

MR. BARGER: Because there's a real interesting tension, which is -– I mean your poll about health-care retirements was amongst retirees. If you were to ask people that were 20 years old when they were thinking about going into state service, that probably would be way down on their list of priorities. The people that would value those sorts of things, like having their pension be a little bit bigger or the retiree health, a bigger proportion be picked up, would be people close to that retirement age, presumably. You know, to be effective in thinking about retention, I would think.

The other part of it is, it strikes me a little what we were talking about, isn't just retention. I mean, if you take vesting from five years and make it ten years, half, to 20 years, you're also talking about reducing the costs, presumably.

MR. BRANAN: Yes.

MR. BARGER: Because you'd have a number of people who would never qualify, et cetera. So it strikes me, this isn't just a comment about retention. It's actually more of a comment about this would be maybe a more cost-effective way to go about this.

MR. BRANAN: It’s both of those things.

CHAIR PARSKY: It's within the concept of competitive affordable benefits package. It's a combination, an attempt to address both concepts.

MR. BARGER: So, anyway, it struck me that we left out that little piece of it.

And I guess I’m still struggling also to sort of think sort of how this looks. I mean, in some ways, I can imagine having the recommendation without having the finding because in some way, the finding is almost the thing we're arguing about, to some extent, more than what might be sensible things for people to consider in various situations and to bargain at the local levels for.

CHAIR PARSKY: I think that's a very good comment.

I'm not at all sure that we would all feel it was appropriate to put the finding into the final report. But I think by way of getting the discussion going, I urged the staff to put it up there. But I think you're right, the findings, quote, may cause more disagreement or controversy than the actual recommendations.

MR. WALTON: And if we're going to fight over something, let's make it count.

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

Yes, do you have one more on this subject?

MR. LIPPS: I just wanted to offer a recommendation. In terms of the level of specificity that we should be looking at, or lack of specificity may be a better way. But if a recommendation on this issue were to read something like, "If they decide to offer them, that state and local public agencies and employee groups consider a vesting schedule for other post-employment benefits for new hires." It's a policy recommendation. I think it echoes very much what John said. But I don't think we should then get into specifying certain time periods and levels. That should be done locally.

CHAIR PARSKY: Well, once again, the purpose here is not drafting. The purpose here is to give the staff input.

I think all of those comments should be taken into account. Maybe we should expand the recommendation to relate somewhat to the pension area, in addition to the health-care area, make sure that it's clear that we're not trying to disrupt local control, the collective bargaining. All of this is exactly what we're hoping the staff would get, unless the Commission felt that the subject matter itself shouldn't even be addressed at all. And I'm not hearing that. Then what we would intend to do, is to give the Commissioners an opportunity to review drafts where you can give editorial comment, so -- and we're just trying to mechanically get to the point where a report can be issued in the time frame that we've been afforded, as opposed to expanding this commission beyond five years or anything like that.

So there is a method to my madness here, but I'm more than happy to receive any suggestions.

All right, one, Dave, you first.

MR. LOW: A couple of comments were made with regard to pension issue, and I just think it's important that we make a clarification here.

Two of the comments were that we've lost some proportionality with regard to pensions. And I'm not sure I agree with that.

Isn't it true still that under most pension systems, even with the change in formula -- if you can retire at 55, for example, at 2 percent -- the percentage continues to go up until age 63, in most systems, and the maximum retirement is at age 63. So there is proportionality. And if you want your full retirement benefit -- maximum retirement benefit, it's at 63; isn't that true?

MR. BRANAN: That's correct.

MR. LOW: And so it sort of depends on when you start, too. I mean, 2 percent of 55 may sound like a lot. But if you started and you only worked five years, you're only getting 10 percent of your final compensation.

MR. BRANAN: Right.

MR. LOW: So there still is proportionality, even with the change in formulas.

MR. BRANAN: There is proportionality. But I would argue, it's not the same proportionality between leaving early and staying longer that it used to be in the 2 at 60. But definitely, there is still an element of it.

CHAIR PARSKY: Well, inherent in –- and I don't even want to use the word "finding" anymore -- but inherent in the finding that was there was an acknowledgment that there was proportionality on the pension side that wasn't matched on the health-care side.

Okay, two more comments.

Curt?

MR. PRINGLE: A couple things.

CHAIR PARSKY: Mr. Mayor?

MR. PRINGLE: I know that Lee is attempting to recraft that or reword some of that, so however that may fit in. But I do think, part of hearing both sides of this is somewhere writing the reasonableness or the caution that should be expressed to provide a full 100 percent benefit of health care at a low number, or the assumption that there would be a benefit but setting it beyond the reach of -- I mean, where we can -- if we're going to talk about numbers, let's show both sides and say that there is concern or caution with such a low number of years to get that 100 percent. Or if there is a representation of employees, that they could get that benefit, that 100 percent benefit but that is unattainable by requiring 35 years of continuous service or something, those are things that we should add to that type of concept. So you see both ends that you've got to be telling the truth and being reasonable.

Under this concept of actuarial equivalency and the whole discussion of pensions, I do think that we should maybe contemplate a couple other components to this, and really address some of the pension stuff to a bid, and that is, you know, we’ve kind of rushed across this -- and I'm not going to get into a debate, but I know some firefighters in my city and maybe even the fire chief doesn't necessarily want to retire, but there's not only zero incentive to continue to work under the present system, but a negative incentive for him to work because he is basically -- he could be home, retired, and making 90 percent of what he is making because he put in his 30 years at a 3-at-50-type concept.

So there isn’t a continued incentive to work, regardless of -- you know, in some retirement formulas there may be, but in some, there are not. So I think expressing that concern in some fashion, I think, is reasonable.

And secondly, if an individual does contemplate retirement from his present job because they can get their maximum retirement benefit of whatever it is, capped out at 90 percent in some cases, I actually would like to have, under this category, something that encourages those who wish to find additional opportunities to provide public service not to be punished for reentering or moving into another system and, in fact, having to give up all of their retirement to do that.

And I think there's great value, even under the actuarial-equivalency discussion, to say should a pension benefit be eliminated because someone wishes to put in service in another system or a different job. Should they get a reduction of their pension in a proportionate amount to their employment? I don't know. I don't think so. I think that's something that we should be encouraging. And under this discussion of actuarial equivalency, I think this may be a good place to put that.

CHAIR PARSKY: Bob?

MR. WALTON: Thanks. I think, trying to expand also along with what Curt mentioned, I think in the findings, my concept, again, is that we'll have discussion about the importance of retirement health benefits, OPEB benefits to recruitment, retention in the public sector within California, that sort of thing.

One thing I think that we may want to include in here, especially about retention, is retirement incentives like STRS has, likes the City of Fresno has in their DROP program, where, in fact, current programs have disincentives to retain employees. For instance, the safety cap. If you reach 90 percent, there is no incentive to stay longer. That is one place where DROP may prove successful in retention of employees.

Some of the other formulas also don't increase after a certain age, especially in the safety. Again, something like STRS did to help retain employees.

I think we may want to include in the discussion when we talk about recruitment or retention, the fact that it's getting more and more difficult to find adequate employment for its workforce, especially in the public sector. And so I think these things are important when we talk about proportional benefit design, is how are we going to recruit these people in the first place? And once we get them and they are fully trained and have experience, how are we going to retain them? Because in a lot of instances, on the pension side, there is no incentive to staying after a certain point in time, as much as there is maybe in health, where you have up to 20 years. So it may be another aspect that we would want to incorporate into this item.

CHAIR PARSKY: Great. Okay.

Let's move --

MR. COTTINGHAM: Sorry, I just want to interject one thing, is that when we're talking sometimes about the 100 percent benefit, on medical -- the health care, as a person goes out, I mean, maybe that needs to be defined. Because it's really not 100 -- they pick a point in a plan where they will cover that. It's not like any plan you want and they cover 100 percent. So even if it sounds like it's 100 percent, it's not really. It’s a capped 100 percent so that weighs into the formula also.

CHAIR PARSKY: Okay, let's move to subject Number 2 under this concept.

MS. DOUGHERTY: Actually, Mr. Chair, I'm sorry to interrupt you. But before we move forward, can you recap? I just want to make sure the staff has some direction. I know, not all the details. I've been taking copious notes, I promise.

Just in terms of do we want to take some additional look at the pensions piece as it relates to proportionate or proportional benefit design?

CHAIR PARSKY: Rather than try to recap everything here --

MS. DOUGHERTY: I'm not asking for everything.

CHAIR PARSKY: -- I think we do want to see whether or not, under the concept of proportionality, commentary about the pension area is appropriate.

MS. DOUGHERTY: Okay.

CHAIR PARSKY: And I do think that in connection with -- again, with all the caveats -- but making a recommendation perhaps to alter a five-year program, it should be really coupled with more on the incentive side.

If it's done, then potentially you want incentives that go with it. You don't just want to change the five years without creating incentives for remaining longer.

It looks almost as if it's kind of -- the recommendation that is coming out would be, change the five years, don't change any of the incentives. And that may be cost savings, but it's not consistent with trying under the overall concept to retain public employees. At least that's the way I took it from the comments.

MS. DOUGHERTY: Great. Thank you.

CHAIR PARSKY: Okay, let's move to the next subject matter, again, under this concept, which is "*Three-Legged Stool*."

MR. BRANAN: The *Three-Legged Stool*. This is a concept that's usually thought of as a theory that the combination of an individual's personal savings, Social Security, and a government-sponsored pension will provide a secure retirement.

Now, we have looked at those three options. We've shied away from Social Security in terms of making recommendations. But a potential finding that we have is that personal savings for retirement have significantly declined in recent years and, in addition, many public-sector employees do not participate in Social Security. And that led us to the notion that,

Number 1: Public sector employers should provide tax-advantaged supplemental savings plans for their employees, and plans should be offered regardless of an employer match."

And Number 2: Tax-advantaged supplemental savings plans should be offered to employees on an opt-out basis. And under this approach, employees would be automatically enrolled in the plan but they could choose to opt out at any time.

CHAIR PARSKY: Go back one more time to -- we're going to eliminate in the future the word “findings." We're just going to say, part of the introduction, but personal savings for retirement have declined significantly. In addition, many public sector employees do not participate in Social Security.

That may or may not be debatable, I don't think so. But then the concept would be one or more recommendations relating to that as outlined. But, again, not so much wordsmith as the concept of the recommendation. You can move it to the recommendation now.

So comments about these two?

Within this, maybe there should be others, or maybe people don't like the words "three-legged stool," maybe you want to say or use some other language. But I think we agree that the subject matter was appropriate under the overall concept.

Jim?

MR. HARD: Well, yeah. It's noted here, but I think on average, the savings -- not public employees, but savings is zero in the United States. And, actually, people are, you know, creating debt, and that's why you have all that. So certainly the three-legged stool is kind of like in trouble.

DR. GHILARDUCCI: Usually, they use a pyramid.

MR. HARD: A pyramid scheme, huh?

CHAIR PARSKY: Maybe we should change that.

MR. HARD: I don't know if I want to go from a three-legged stool to a pyramid scheme, but…

And then a lot of people are not in Social Security. So I think -- I don't want to wordsmith, either. But the savings is not a particularly practical view of how working folks are going to have anything in retirement.

CHAIR PARSKY: Well, again, I would focus a little bit on the interrelationship between the two. I mean, the first is an urging, if you will, that there should be tax-advantaged supplemental savings plans.

MR. HARD: Yes, I have no problem with that.

CHAIR PARSKY: You should have one.

The second -- and I would focus in on the opt-out concept. The concept would be, if you have such a plan, to place somewhat the burden on the employee to come out, he or she can come out, but they would have to opt out.

Dave?

MR. LOW: I don't have an issue with either of these; but I would suggest that one other thing we might want to consider, which is the education component of these issues. I think that one of the biggest problems is that a lot of people don't participate in these plans because they don't understand them, they don't understand the tax advantages, they don't understand that contributing to them is not going to reduce their net income as substantially as they might otherwise think. They don't understand the time value of money. And we don't do enough financial education to bring a lot of people up to speed in terms of putting aside this money over time for their retirement savings.

CHAIR PARSKY: Yes, Curt?

MR. PRINGLE: Well, actually, I thought at our last meeting, I said I didn't like the whole concept of putting up a three-legged stool at all. And one of them was this element of personal savings which I now like these recommendations. So --

CHAIR PARSKY: We listened to you.

MR. PRINGLE: Well, to a certain extent. Because under the last discussion, I thought we said where we wanted to have at least some mention about Social Security. And here, in the discussion of three-legged stools, we're avoiding the other leg in one fashion or another, anyway.

Is that coming next or --

MR. BRANAN: No, not unless the Commission wants it.

MR. PRINGLE: Well, I would actually like it or at least like to have a discussion among the members here. That I think, however, our report can encourage participation in Social Security, I think we'd better not use the term three-legged stool unless we do, in fact, talk about Social Security as a component in some fashion.

MR. BRANAN: Well, I think what we're doing is recognizing that there is a three-legged stool, at least that concept.

MR. PRINGLE: But there isn't for those

districts and those government entities that restrict their membership from participating.

MR. BRANAN: That's true. And approximately one-half of all public employees in California are not in Social Security.

MR. PRINGLE: Therefore, isn't that something that we should at least comment on? I would like to comment on it. I would like to encourage participation. I would like to have our report encourage agencies to consider participation and not mandate, but at least say that that's something that we think is worth consideration of participation, as opposed to avoiding it and not talking about it at all, after we referenced the three-legged stool.

CHAIR PARSKY: John?

MR. COGAN: First, the question on Social Security. Those employees that are not in, are not in because their districts have elected not to go in?

MR. BRANAN: Have elected not to go in.

MR. COGAN: Right. So nobody has prevented them from going in.

MR. PRINGLE: Oh, yes, they are because -- that election took place when? Is that a regular election?

MR. BRANAN: No, although an agency can join Social Security at any time. They just can't get out anymore.

MR. PRINGLE: But I guess the response to that, John, out of order, being rude, would be the fact --

CHAIR PARSKY: Go right ahead.

MR. PRINGLE: -- there was a time in the past that those employees may have considered that. But today, those employees aren't given that opportunity; are they?

DR. GHILARDUCCI: They are; aren't they?

MR. WALTON: It's up to the employer to participate in Social Security --

DR. GHILARDUCCI: But it's bargained.

MR. WALTON: -- but it's usually through a bargaining process.

That's right. It's just no different than they elect to become part of PERS or any other retirement plan. That's part of the bargaining process. It's up to the employer to contract for Social Security coverage. So it's an option now.

The employees themselves don't normally vote on that unless it's through bargaining.

Once they come in, there is an election process, as I recall, on whether current employees can opt out or go into the Social Security program. I know that's the case many years ago, over 30 years ago in the

State of California, that when the State elected to go into Social Security, the current employees at that time have an election to: “Yes, I'm going to go into Social Security” or “No, I'm going to stay out.” In fact, there's a handful -- not many -- that are still state employees that are not in Social Security because they elected not to be 35-plus years ago.

CHAIR PARSKY: Lee?

MR. LIPPS: For the teachers in California, the only one that they are entitled to is Medicare, and that's if they were hired after April 20th, 1986. They are automatically enrolled, and there is no choice. The District pays roughly a 1.5 or 1.45 percent contribution, and they match it out of their paychecks. They don't have right now the option of going into the full Social Security program.

For teachers hired prior to April 20th, 1986, if they choose to have an election, the teachers vote, and if they choose to opt in to Medicare, then they can do it. But there are well over a hundred districts that have never held an election, and those teachers in those districts are not entitled.

In some part, it's because the districts are very, very rural, and there may be, you know, 50, 60, 70 of those where they still haven't heard that they can have an election and opt into Medicare. And I'm not making fun here, it's just the employees don't know. But there are some large districts that have chosen never to have an election. So it is an elective process for the employees, the teaching employees of a district; but not with respect to Medicare if you are hired after April 20th, 1986.

And if I have misstated any facts, I have two colleagues -- three colleagues -- four colleagues out there who will be happy to correct me.

CHAIR PARSKY: John.

MR. COGAN: Let me come back for a moment to the two recommendations that are up there, both of which I could support very easily, with a little caveat on Number 1, and that would be, I do support employer matches as a general rule, but the reason the Commission is here I think is because employers haven't funded the liabilities that they've incurred. And it seems to me it would be inappropriate for us to be recommending with enthusiasm that they incur more liabilities for retirement by paying out an employer match.

CHAIR PARSKY: The second sentence there -- and this is not meant to be wordsmithing -- was not intended, I don't think to encourage employers to match it, whether they do or not.

MR. COGAN: Right.

CHAIR PARSKY: The staff will note that.

MR. COGAN: I think the caveat –- yes, and coming back to Social Security, Curt, my sense is that there's a reason that employees haven't jumped into Social Security as opposed to Medicare. I mean, A, it's a bankrupt program. The benefits are far from certain.

DR. GHILARDUCCI: Oh --

MR. COGAN: And second, even if you were to get the promised benefits under Social Security, I think the rate of return on your contributions is on the order of one or two percent real rate of return.

And so I think many employees that haven't opted into Social Security, those that have had a chance, have done so on a perfectly rational basis. And they're as bad as many of the pension programs are funded at the state level and the local level. Social Security is in very bad shape itself.

MR. BARGER: Unlike Medicare.

MR. COTTINGHAM: I'll start with the recommendation because I'm concerned about it. If you're saying the employee has to positively opt out, and does that mean the employer is going to put them in; and then the only way to put the employee in is to somehow force the employee to make some minimum contribution? So that may be a difficult concept, unless it's at the time of enrollment in signing your forms, you're giving this and saying, "You're going to go into this unless you opt out."

But on Social Security, I think there's some things that haven't been discussed, and that is that there is a cost to the employer. I mean, you're going to have a cost of payroll of about 7.5 percent for each employee if you put them in because the employer and the employee share the cost. If they're having difficulty with their pension payments or whatever they're doing, then they're going to have difficulty making that Social Security payment. So that's a negative.

Also, in our wonderful country, there's something that the Social Security Administration has done that is referred to as the government pension offset and the Windfall Elimination Provision, which whereby if you have paid into Social Security for 25, 30 years, and you retire, you're not going to be entitled to your full benefit because you're getting another pension. So they're going to diminish it by that.

If your spouse is getting a Social Security benefit and you're getting a pension, they're going to diminish your spouse's benefit by the Windfall Elimination Provision. So that's something that we have been lobbying on for the past -- Feinstein has a bill, Senate Bill 206, called the Social Security Fairness Act. It's been in place for anywhere from 12 to 14 years that we've been lobbying and trying to get rid of those.

So those are some negatives by trying to bring Social Security into the three-legged stool. So I guess we have a two-legged stool, which is even more of a balancing act. But maybe that's where we are, is trying to balance all this stuff.

CHAIR PARSKY: Well, I guess in one sense -- and this doesn't mean that Social Security shouldn't be addressed -- but in one sense, these recommendations really relate to encouragement of savings as a way to create an attractive package for employees -- public employees to supplement other benefits that they have, irrespective of whether Social Security is something that the employee is in or not.

So maybe the subject matter can be recrafted a little, but still include in it some specificity about the Social Security, the impact of Social Security on it when it's provided, something like that.

Matt?

MR. BARGER: The other thing –- I mean, just sort of touching on sort of odd parts about Social Security of having half the public agencies have it and half not is recruiting again, which you've got as sort of the other side of, money that's going out is not going as current income to somebody.

MR. COTTINGHAM: Correct.

MR. BARGER: So it's sort of another rational choice that somebody that age who is making a decision about whether or not to go into public service who is in his 20’s, again, isn't probably valuing very highly the Social Security even if they believe it's not bankrupt, relative to just getting paid some more. So there's sort of another rational choice at that point to say, you know, current income is worth more to me than the pension.

And sort of having this half the people have it and half that don't, you do get into situations where people are competing head to head for the same people, and even with public agencies. I look at that and go, that does strike me as an issue. I don't know quite how you address it.

I was just laughing. Medicare is in worse shape I think, honestly, than Social Security. And yet I think most of us would sit there and go, that part of the recommendation that I don't see here, you know, trying to have people enrolled in Medicare makes sense, to narrow the gap. And it strikes me as something we at least ought to comment on, which I don't see up there in the --

MR. BRANAN: That's later today.

MR. BARGER: That's later? Okay.

CHAIR PARSKY: That's coming.

MR. BARGER: And the last part about these savings plans in terms of opt-ins and opt-outs, I think the other part that people discover is that people are too conservative in how they invest. They tend to go to all-bond, all-cash sorts of alternatives and setting up some sort of an opt-out program that says you have to be in a variable annuity or some model portfolio that changes as you age or some part of that also would be worth commenting on because that's dramatic differences over, you know, decades.

MR. BRANAN: Yes. And when looking into this, we found that that is becoming a much more popular option for employers to offer.

DR. GHILARDUCCI: Because of the life cycle.

MR. BRANAN: Yes.

CHAIR PARSKY: John?

MR. COGAN: Along the same lines there, Tom, if we were to go with Number 2, Option Number 2, then you want to maybe supplement the discussion with some treatment of what the default option is.

DR. GHILARDUCCI: Right.

MR. COGAN: And the default option is the most important feature of this program. Once you have people opt out, then if somebody doesn't fill out their form, they're in. And then the question is, what type of pension fund are they in? Is it an all-bond fund? Is it a treasury fund?

So you'll need to address that.

MR. BRANAN: We certainly can discuss what's out there. But it occurred to us that would be something to be determined at the local level, what they were going to offer.

MR. COGAN: Oh, yes, right, right. But you would want to, I would think, educate people on -- and I'm thinking of the employers, not the employees so much -- but the employers on how to set up that default option. What are the issues involved there, right?

MR. BRANAN: Uh-huh.

MR. COGAN: The second point is that I think there's a lot of academic studies that have looked at how much of a difference the opt-out basis has for encouraging individuals into pension funds. And it's huge.

MR. PARSKY: It’s very big.

MR. COGAN: Yes, and maybe you'll want to draw from that literature as a way of introducing the recommendation.

CHAIR PARSKY: I think that's a good idea. I've seen some of that.

Bob?

MR. WALTON: Not to turn this entirely around, but in hearing all the discussion, I hadn't thought of this before. Perhaps this whole issue ought to be recharacterized somewhat differently. And it really gets back to personal responsibility for planning your retirement. And using the three-legged stool as an example, I think often in the past, people do not recognize their level of responsibility in planning for their retirement. And that could incorporate the education effort, both their own responsibility, as well as the employer, to educate them on personal responsibility, including savings.

I know PERS -- I was involved in doing some retiree surveys in the past. And a significant number, when you ask them about savings, either looked at it in two ways: No, they didn't need any because they have their pensions and Social Security, if that's the case; or, a large number at that time -- this is about five years ago -- said, "Oh, yes, I have lots of savings." And when you went and delved into that, it was their home and the appreciation of that home.

And the fact was that we found a high number of people that retired within the first year sold their home, and actually moved out of state. I think 16 percent moved out of the state within the first 12 to 18 -- and so they looked at savings differently than our concept here.

But I think if we look at this whole issue on the person’s responsibility to take charge of their retirement planning, including whether or not they're in Social Security, including on whether or not they have personal savings, I think it could incorporate the education component as well as others we've talked about.

CHAIR PARSKY: Teresa?

DR. GHILARDUCCI: I have five things saved up. They should be quick.

CHAIR PARSKY: You have five things?

DR. GHILARDUCCI: Yes.

CHAIR PARSKY: Okay.

DR. GHILARDUCCI: The first one, I agree with the recommendation that we, I guess, encourage employers to offer an opt-out program. I think that we should take with some caution what Ron said, that we should care about whether it's a soft opt-out or a hard opt-out, how that's done.

CHAIR PARSKY: Right.

DR. GHILARDUCCI: Maybe staff could talk to Ron more fully about what he means by that and do some research on soft and hard opt-outs.

Two, I just wanted to go back to this -- maybe this will help you, Stephanie, because you wrote a really good paper for the Commission on the various ways that defined benefit plans are used in a personnel tool.

Did Grant help, too?

MS. DOUGHERTY: That's Grant's baby.

DR. GHILARDUCCI: I'm not surprised. It was great.

And I think what I heard here is that the Commissioners might not know whether or not there are a lot of places in the state where people run up against some kind of a disincentive to work longer. I had the impression that they don't. But what I heard here is that some people think there is a lot of that. Because even if you can retire at 50, what Dave said, with 2 percent credit, if you've only worked for five years, that's really no incentive at all. So if you can just flesh that out a little bit, about what exists on the ground now. I would suspect that there's a lot more incentives to work longer because you'll get a higher pension than we know.

That was two; right?

Third, language that's been used in Europe a lot, and it's creeping up in the academic literature, is reflective of Jim's idea that saying a three-legged stool is kind of like being *"Leave It to Beaver"* again. You know, it's really a 1950's concept. And people are using the word "pillar" more, that there are these pillars, and that means that they could be a different size. So you might want to think about that.

But the more substantive point is that when we talk about pillars here, we're not talking just about employer pensions from the state, personal responsibility in savings, and Social Security, we're also talking about Social Security/Medicare. And I think the discussion that we're going to have later about how much Medicare has been woven into what the state offers their retirees, that may make the Commissioners realize that we have much more of a three pillars than we might think, even though half of the folks are out of Social Security.

Next -- I guess that's three?

CHAIR PARSKY: You have a number attached.

DR. GHILARDUCCI: Four, four. Yes, I rearranged it.

Four, is that I think Dave Low's point is excellent. And we might want to really push this, that we should encourage all the pension systems in the state to put on their agenda financial education of their participants.

The best practice of pension systems is that they are appreciated by their employees. If there is a pension system out there that is not appreciated by their participants, it fails. It's just not a good system. And partly because I think trustees and the staff don't realize that continuing financial education is key to their efficacy. So if this Commission can really be strong in that, that would be important.

For instance, 70 percent of people who have defined benefit plans don't know they have one, even though 90 percent of the people who have a 401(k) or a DC plan know they have it. And it's even worse if you get below the age of 40.

And last, I'd like the record to show that the Commissioners probably disagree about the status of Social Security and if it’s bankrupt or not.

CHAIR PARSKY: I think it's --

DR. GHILARDUCCI: I’d like to state it's not.

CHAIR PARSKY: I think it's safe to say that we won't try to make any broad statements about the financial health of Social Security.

DR. GHILARDUCCI: Okay, all right.

CHAIR PARSKY: There was another Commission that John and I served on.

DR. GHILARDUCCI: Yes, I realize that.

CHAIR PARSKY: And all of our thoughts are in that report.

DR. GHILARDUCCI: Oh, I think I read it.

We probably should advertise the fact -- this is really interesting, what Lee said is that many of these agencies might want to revisit this idea of opting to elect into Social Security or may be apprised of the fact they can do it. And I think you're right, we might want to -- that Curt's right, that we might want to put that on the table.

MR. COGAN: You know, in Washington, my years in Washington, proposals were regularly made to require all state employees to come into the Social Security system. And the biggest lobbyists against it were the representatives of state and local employee associations and governments, because they were half the payers.

CHAIR PARSKY: Lee?

MR. LIPPS: John, when you were speaking of Social Security, was that morally bankrupt or economically?

DR. GHILARDUCCI: Stop.

MR. LIPPS: Both Bob and Teresa have mentioned things around personal responsibility for planning a retirement. And that always sounds very, very good. And it sounds like if you don't plan for your retirement, you're not being personally responsible or you are being irresponsible. But there are employees, by virtue of what they make -- you know, $15,000, $20,000 $25,000, particularly if they're single, particularly if they are single and have children -- that we can't create enough incentives for them to save because they're living in the Bay Area -- and this includes teachers -- they're living in the Bay Area, literally spending every cent they have, and they're living in a deficit finance world on a personal level. So I know we can't do anything about that concept, but I don't want people to have the impression that people that don't save are necessarily irresponsible.

MR. WALTON: Right, I understand.

DR. GHILARDUCCI: They could be very responsible.

CHAIR PARSKY: Maybe as the staff thinks about heading here, you may want to just think in terms of planning for retirement and then let the other concepts kind of flow with that.

Now, Stephanie, out of all this confusion, do you think you're okay in terms of where you want to --

you clearly want to supplement this with discussion about the default option, how it would work, we want to make sure we include that, have the emphasis on education. I think the underlying recommendations with the right introduction and everything seems to be supported.

MR. BRANAN: Mr. Chair, I have one other thing to add. And two of the commissioners have brought up the question of the difficulty of savings and what would be, if they're in, there must be a required contribution. And Ashley Patterson of our staff just yesterday found two cases, Indiana and Texas, that in the middle of this year, began opt-out savings plans for their state employees. And in the case of Indiana, a minimum contribution is $15 a month. And I think the idea there is to get people used to saving and to see how it grows over time. And in Texas, the minimum contribution is 1 percent of pay. So it's correct, there would be a mandatory element, but it doesn't have to be onerous.

CHAIR PARSKY: Okay, the next subject?

MS. BOEL: Gerry, lunch is available. We could get it and bring it back, if you want.

CHAIR PARSKY: I'm keeping my eye on lunch. I'm just trying to get through this. So let's try by keeping the commissioners a little hungry. It may help things.

MS. BOEL: I'm just trying to be helpful.

CHAIR PARSKY: I don't want them grumpy but hungry.

We'll just do the third concept, and then we'll have lunch.

The third concept, vesting. Let's see if we can get through this in 20 minutes.

MR. BRANAN: This next one we've entitled "*Understanding of Health Care 'Vesting.'*" And "vesting" is in quotes there, as you'll see. And we will discuss that.

"Vesting" means that employees are entitled to their benefits within a certain period of time, even if they no longer work for their employer. "Vesting" refers to an absolute right, as opposed to an expectation.

The finding that we have come up is the following: The Commission has heard extensive testimony on situations where the process for vesting for health care was not understood by actives or retirees.

And that was primarily in your earlier hearings, where you heard retirees from three counties.

Potential recommendations: Public employers should provide clear policy statements to employees concerning current eligibility rules for retiree health care and the terms under which retiree health care is considered to be a vested benefit.

This information should be communicated at regular intervals throughout an employee's career and throughout plan documents and collective bargaining agreements.

Number 2: Public employers should clearly explain to their employees how health benefits for retirees are to be funded and paid, including full funding, partial funding, employee-employer split, et cetera.

CHAIR PARSKY: Okay, first, is the concept of vesting understood by --

"Vesting" has kind of different meanings in the world than Matt and I have lived in, and it may have a little different meaning than this.

MR. BARGER: Shorter.

CHAIR PARSKY: Okay, comments about this underlying policy/recommendation?

Dave?

MR. LOW: I think that this vesting issue is a touchy issue in the respect that in California and, actually, nationwide, for public employees, the vesting of retiree health benefits has not been tested through the court system. We have a totally different law with regard to private-sector retiree health care --

MR. BRANAN: Correct.

MR. LOW: -- which essentially is not vested.

The question of whether a public employee retirement health care is vested or not is up in the air. And I don't know that we can really fairly ask an employer to state whether the benefit is vested or not because I'm not sure the employers can provide an answer that is legally defensible. They might say it's not a vested benefit, and they may be wrong. Even the first hearing that we had this year down in Orange County, when the employees, the retirees come forward, the employer and the labor union locally negotiated to eliminate retiree health care --

MR. BRANAN: Well, one labor union.

MR. LOW: -- for their existing retirees.

And the question of whether that was a legally enforceable decision still could be tested in the courts, and they could lose.

MR. BRANAN: That's true.

MR. LOW: So I just think that we have to be very careful about telling employees that the employer can tell them whether their benefit is vested or not because I'm not sure that the employer is going to give an answer that I would agree and you would agree with or that anybody should agree with.

MR. BRANAN: In that regard, that's why on the first page we had "vesting" in quotation marks. We're more comfortable using "eligibility." But we didn't want -- after we had shown you these topics under certain names, we didn't want to bring them back to you with a different name.

MR. LOW: I'm a lot more comfortable with "eligibility," too.

CHAIR PARSKY: Yes, I thought that since we had discussed the topics and we agreed that the topics would be on the agenda, I didn't think it was right to change the topic subject matter, because we could agree it could go on. But there was a clear feeling that it should be eligibility.

Yes, Bob?

MR. WALTON: Quickly, on where we are at, Number 3, Pension Issues, “There is no known pension issues regarding vesting.” I'm not sure if we even need that at all. Some may argue that. For instance, the City of San Diego may argue that. It's just something I don’t know that we need to include in this report.

MR. BRANAN: The reason it's included is we wanted to develop a format that was almost a checklist for every issue. And we did say “known.” That leaves open a lot of things we're not aware of.

MR. WALTON: Well, the lawsuits in Orange County are known, and they include vesting issues towards retroactive benefits.

MR. BRANAN: Yes.

CHAIR PARSKY: Yes, I think, Bob has a good point.

Other comments?

Yes, Matt?

MR. BARGER: I was actually wondering if there is something like this in the actual report, or is this for developing the report.

CHAIR PARSKY: Do you mean the background piece?

MR. BARGER: Yes.

CHAIR PARSKY: Yes, the background piece is -- to some extent, some elements may be included in the introduction, but it's really meant for us here to then lead to a set of recommendations.

MR. BARGER: Yes. We don't need to argue over this.

CHAIR PARSKY: No, no. You will have an opportunity to comment on every element of the draft report, but it's going to be really focused -- there will be a background piece -- the information that we will be collecting. But this is meant to lead us to the recommendations.

Okay, no other comments here?

DR. GHILARDUCCI: Lunch?

CHAIR PARSKY: No, no. Wait. We're moving right along. Not quite yet.

If Teresa says absolutely she is ready, we'll go to lunch, but not quite yet.

MR. PRINGLE: Mr. Chairman, I think we need to be respectful of Teresa. She is on Midwest time.

DR. GHILARDUCCI: That's true.

MR. PRINGLE: She's three hours late for lunch.

DR. GHILARDUCCI: Thank you.

MR. WALTON: I think it’s two hours.

DR. GHILARDUCCI: Three. Thank you.

CHAIR PARSKY: You know, the mayor, I've discovered, is not the only elected official on this commission who corrected me last time.

If you can just bear with me, 12:30 we'll break for lunch.

Okay, the next subject? Tom?

Part-Time Employee Access to Health-Care Risk Pools. We divided up the -- it was a combined subject before. We've made it a separate subject, if you will.

MR. BRANAN: *Part-Time Employee Access to Health-Care Risk Pools.* Health-care risk pools refer to the size, demographics, and overall health of the population covered under any health plan. For the purposes of this discussion, a part-time employee is defined as an individual who works less than full-time in an established position and whose hours worked are insufficient to qualify for participation in an employer's OPEB plan.

The potential finding is that a larger risk pool is better able to achieve lower costs through purchasing power and through the spreading of underwriting risk.

And for "Potential Recommendations,"

Number 1: CalPERS contracting agencies should be informed of the option to allow permanent part-time employees access to the health-care system. The amount of the employer contribution, if any, should be collectively bargained.

And Number 2: Individual part-time employees should be allowed to access the PEMHCA pool. The amount of the employer contribution, if any, should be collectively bargained.

CHAIR PARSKY: Okay, Lee?

MR. LIPPS: Tom, just a clarification question, if I might.

This legislation you're referring to under

Number 2, does this only apply to people that want to enter the CalPERS health-benefit system, or does this apply to all public agencies that may have local health-care contracts?

MR. BRANAN: No, I think it's just agencies in PEMHCA, the PERS health-care plan.

MR. LIPPS: Because --

MR. BRANAN: One second, let me confirm that.

Yes, my experts tell me that I did good.

MR. LIPPS: Because we do have a number of health arrangements or groups, whether they're a trust, and so on, that where the insurer, the insuring company, will not insure anybody who does not work, for example, at least 40 percent of the time, even if they want to opt in. So that does exist out there. And this is one of the incentives, so to speak, that school districts have to keep people as part-time employees, so that they do not have to give them access to the health-care pool, particularly on a proportionate payment basis.

CHAIR PARSKY: Bob?

MR. WALTON: Two points. And one I will attribute back to my colleague to my left to take credit or blame.

I think, Tom, that this recommendation ought to apply to any public-employer-provided health plan, whether it's PEMHCA or not.

If I'm in a non-PEMHCA health plan with the City of -- whomever -- that part-time employees or that employer ought to have the same recommendation. That's one point.

Two, I think in the discussion, there ought to be some mention, in some context, of the downside potential that this has, and that's the adverse risk. When you have a -- because some, especially schools, have a large segment of part-time employees. And if you give them individual choice, quite often what happens is only those that are sick, really need the health care, are the ones that join and cause an adverse risk to the entire pool.

Now, in larger players, that's probably very, very minimal, if at all. But some other employers, it could be significant.

MR. BRANAN: That's correct.

CHAIR PARSKY: Well, let's just stay with how that relates to what I -- again, I don't like the word "finding" -- but how that relates to the finding that you had there, because that seems to run counter. Maybe the "finding" wasn't articulated, really.

MR. BRANAN: No, I don't think they're in conflict.

The finding is the beneficial effects of having larger pools. And what Bob is talking about is the adverse selection that you always get when you let people opt in or out of a health-care plan as needed.

And we struggle with that, too, in terms of should this be -- that these people as a whole group go into PEMHCA or individually. And you're right, there is adverse selection.

MR. WALTON: Especially at the individual-choice level.

MR. BRANAN: We weren't ready to say that there would be adverse selection if it was done by group, but certainly by individual.

MR. WALTON: I agree.

MR. PRINGLE: Mr. Chairman, I question why this is the finding as opposed to there is greater opportunity to retain part-time employees, there is value to organizations of part-time employees, therefore, health benefits may be an important contributor to public service.

If that's the level of finding, then it's a lot easier to go into why you want to create something, as opposed to -- I don't necessarily think the single-most important finding to offer any type of health-care benefit is just the fact that a larger pool will reduce the risk. Because, in fact, a larger pool may not reduce the risk if the larger pool is defined by the existing pools plus one sick person. That doesn't reduce the risk, and that's a larger pool. So, you know, maybe we look at why -- you know, you've created a finding here for -- just to kind of introduce the issue.

MR. BRANAN: Right.

MR. PRINGLE: And I think I would feel more comfortable if the finding talked about the value of part-time employees to some government organizations, and this being health-care benefits being an important benefit for those employees as well as full-time employees.

CHAIR PARSKY: And, again, we might think of a better word than "finding." Maybe introduction to each of the recommendations or whatever.

Do you have that, Stephanie?

John?

MR. COGAN: Could you put the recommendations back up?

First, I agree both with what Bob and Curt said about adverse selection. I think it's really an important -- potentially important issue for Number 2. We may end up raising the rates -- the insurance rates for all the people that are in the pool now if this recommendation were to go forward, if you have individual selection.

On recommendation Number 1, is it clear that ignorance is the problem on the part of contracting agencies as to why part-timers are not allowed access?

MR. BRANAN: Well, in the case that Bob brought up, where we're talking about employers within PEMHCA, that could be the case, because the legislation is there. And what we are talking about was making sure that it was publicized.

MR. COGAN: I have no problem with making sure it's publicized. It makes a lot of sense. But I do want to caution us -- I mean, we're here because localities have a huge unfunded liability. And we're going kind of down a road and saying, "Well, one of our recommendations should be to expand the benefits." And, listen, I believe firmly that there is a significant advantage to local governments for providing part-time employees health-care benefits, okay. But whether it's in their financial interest to do so, given where they are now, where they're not funding the benefits to their existing employees is unclear to me.

CHAIR PARSKY: And maybe that concept should be incorporated into the recommendation, so that it's a worthy objective, but only in the context of their ability to afford health-care benefits for those that are there.

MR. COGAN: Right, or establishing priorities. Fund the benefits you've promised already before you start loading up on new beneficiaries and benefits.

CHAIR PARSKY: I think the acknowledgment of the importance of encouragement of part-time employment or employees is a good acknowledgment.

MR. COGAN: Yes.

CHAIR PARSKY: But I think John is right, that it's got to be seen in the context of what is affordable and fiscally responsible.

Bob?

MR. WALTON: I hesitate in making this point but I think we should, at least in my mind, I think it's an elephant in the living room we're not discussing.

PEMHCA is the third largest purchasing pool in the United States. Obviously, there's advantages of being larger and the lower cost. That's what this is all about.

One of the things that's not here is why more employers don't join PEMHCA. And the answer is pretty straightforward, at least in my mind -- Richard could elaborate on this -- or Dave, too -- is that PEMHCA requires the employer, if you're under PEMHCA, to cover actives the same as you do retirees.

MR. BRANAN: Right.

MR. WALTON: And there's been attempts in the past, that’s been unsuccessful, to eliminate that option.

I know this is especially true for schools. Many schools only cover their retired up until they are Medicare-eligible and then they drop them.

Under PEMHCA, they can't do that. And that's the reason why they don't join PEMHCA, for the most part. There's others.

So is that something -- and I'm not saying I would necessarily support it -- but I think it ought to be at least discussed as part of this issue.

MR. BRANAN: That the conditions of being in PEMHCA be changed?

MR. WALTON: That's certainly a possibility, or at least addressed in some manner. It can be. I think most employers, or a lot of the employers don't want to take that step. The requirement that concerns them isn't that they must offer help, it's the equal employer contribution. And there are ways to mitigate that, but they don't often want to take those extra steps.

I don't know if you want to get into that much detail, but that's what it may require.

MR. PRINGLE: Well, I do think, Mr. Chairman, we should get into at least the detail of not writing it like this and encouraging people to participate in PEMHCA, if there are those types of restrictions. I mean, I think part of the discussion is however we wish to write it, such that it would encourage access to pools. It's funny, there's always a discussion of local control, depending upon how all of us will use the words "local control" if it benefits our argument.

So I disregard all the previous references to "local control" because I didn't really like them. But in this case I'll say, "Isn't it interesting if we push down a path of part-time employees accessing, quote, PEMHCA, that we want to take away the local control in deciding how that affects retirees' and those part-time employees' benefits and such?"

So, yes, I wouldn't feel comfortable with this as written then, where it would say somehow we are directing other government entities to provide the equivalent benefit to retirees if they so had chosen not to in the past. But I certainly support the concept of trying to figure out how to pool those costs and the pooling of part-time employees into some health pool of some sort, be it this one, be it this one modified by statute, or be it a new one created under statute as this was created by statute, to allow this to exist in the first place.

CHAIR PARSKY: Dave?

MR. LOW: We represent a lot of the part-time employees. And at the risk of being consistent, I would agree with Mayor Pringle, actually, that, you know --

CHAIR PARSKY: We're marking this down. Mark the time and the date.

MR. CAPPITELLI: Maybe he wants to eat.

MR. LOW: This may be the only time this ever happens.

You know, we do believe that there has to be a level of local control with regard to this issue. We don't dispute that there is a potential for adverse selection, if you allow individuals in.

So I think a blanket policy on that is really -- is kind of a risky approach.

On the other hand, with regard to issue of PEMHCA, I can tell you that this issue of illumination of the retiree health-care requirement is a political third rail. And I would caution the Commission against moving into that ground.

CHAIR PARSKY: We've now touched on two third rails. I hear them. I think with that, we can adjourn for lunch to satisfy Teresa.

And I think we've got two subjects to cover after lunch. And I'm kind of allocating about 20 to 30 minutes for each. So I think we should be able to complete this, if we have a short lunch, about 20 minutes, that we will be okay.

(Midday recess taken from 12:28 p.m. to 1:13 p.m.)

CHAIR PARSKY: Okay, we have two more subjects to discuss within the overall concept that we have for today's agenda.

And so, Tom, the next subject is *Retiree Access to Health-Care Risk Pools*.

MR. BRANAN: Yes, Mr. Chairman, Commission. Health-care risk pools refer to the size, demographics, and overall health of the population covered under any given health plan. For the purpose of this discussion, depooling refers to the removal of the retiree population from the health plan risk pool.

The "*un*-finding" --

CHAIR PARSKY: That's good.

MR. BRANAN: -- is, the removal of retired employees from an employer's health plan risk pool is a growing practice with significant impacts to retirees. In addition, the long-term consequences of this practice are unknown, which leads to the following two recommendations:

Number 1: To the extent possible, employers should keep existing health-care risk pools intact, and include both active and retired employees in the risk pool.

Number 2: Where risk pools have been fragmented, employers should evaluate the feasibility of reestablishing health plan risk pools that include both active and retired employees.

CHAIR PARSKY: Okay, comments about this juicy subject?

John?

MR. COGAN: Let me try to dig a little bit deeper into this risk-pooling issue, to make sure we've characterized the issue right.

If I have two very large pools of people -- or let me call it groups of people -- I've got retirees, we'll call them, and I've got current workers, but they're both very large groups. If I put them together, the benefits from pooling, if you will, will be very small, trivial.

If the employee groups or the two groups combine to form a large group from a small group -- two small groups form a larger group -- then the pooling gains can be very large; okay.

So it seems to me that the issue of whether you should have a separate pool for retirees or not is an issue of really cross-subsidization for large districts. It's not a question of whether there are any pooling gains to be gotten from large districts, since the value of pooling has already been gained if they're separate pools.

There might be a pooling gain for small groups, or small cities' retirees and workers. But I don't think it's so for large.

And so you might want to comment on that, Tom, and walk us through that a little bit more -– or, Richard, if you want to chime in.

MR. BRANAN: That's true. There is -- if you have a pool of active and retired employees, there is a subsidy, in that the retired employees pay less than they would in their own pool. The active employees pay more than they would if they were in an active pool only. And that really goes to the root of this recommendation, that if you split those two groups, rather than having a subsidy paid by one and received by the other, you can have a dramatic increase in the costs to the retirees, which on one hand, there is the personal effect on local -- or on retired individuals; and then also, for those people who have been depooled and see their costs go up hundreds or thousands a month for health care, the costs to existing social programs can go up.

MR. COGAN: All right, I think it's important to clarify, though, that the reason that -- there are two possible reasons why retiree costs can go up. One, it has nothing to do with risk. They just cost more, and that's known, let's say with perfect certainty.

MR. BRANAN: That's true.

MR. COGAN: The other is that there is actually some loss of risk-pooling, and that could cause both groups' premiums to go up.

We don't tend to think of the growth in cost for both groups as a consequence of any cross-subsidization. That's just a lack of risk-pooling. And I think most of the effect here that we're talking about for large districts is going to occur not because of any loss of risk-pooling, it's going to be because of the fact -- simple fact that elderly individuals cost more than younger individuals.

But however we go with this, it seems very important for me not to base a decision on this proposal on the idea that for all districts, keeping the retirees together with the employees is good because there are great gains from risk-pooling. Because the gains for large cities is trivial if measurable at all.

MR. BRANAN: Well, I suppose you would have to be more specific about who it is that's enjoying the gains.

And what is good behind this recommendation is that if these two groups are pooled together, right now, the retirees get a cost break at the expense of the actives. But those people won't always be actives. And when they move into the retired category, then their roles are changed, and they are paying less. And it really gets down to the notion of the social contract. Is everybody in this individually, or is there a benefit in having these things together?

MR. COGAN: I'm not sure I agree with that characterization, that it's a social contract issue. I mean, it is a question of who is paying and who is receiving, and not necessarily one of risk-pooling, all right. That's the only point I want to make, is that I can see gains to be had from putting two small groups together -- retirees and workers. But I don't see the pooling gains associated with putting large pools of retirees together with large pools of existing workers.

There's no pooling gain to be gotten by those two groups. The pooling has already been achieved. So separating them out, you're not losing any pooling benefit and you're left with a subsidy.

CHAIR PARSKY: John, your main point is that when you get to a certain mass or a certain number, then you've gained the benefit of that group; and just by adding more to it, you're not gaining anything?

MR. COGAN: Right.

CHAIR PARSKY: So that -- you may disagree, Tom -- if you do, please comment.

MR. COGAN: Yes. Maybe I should be a little bit more precise. That you're not gaining anything from pooling, if you will, from a societal standpoint.

CHAIR PARSKY: Right.

MR. COGAN: It is true that if you were to add retirees to an existing group of employees, the retirees would benefit. But it has nothing to do with pooling risk, because they would benefit even if all of their health-care costs were known with probability one, that they were higher than the costs of the employee group.

CHAIR PARSKY: Tom, do you have a comment --

MR. BRANAN: No.

CHAIR PARSKY: -- or you're okay with that?

MR. BRANAN: No comment.

CHAIR PARSKY: Yes, Mr. Mayor?

MR. PRINGLE: It's interesting to hear the pooling discussion and pooling lesson.

I don't know why we would necessarily care or necessarily want to encourage pools to stay together.

I didn't necessarily hear through all of the concern about retiree health programs and the disconnection of retiree health as a cost-saving mechanism that some have used and some governments where we got a lot of folks stirred up about it. I didn't think that had anything to do with pooling, necessarily. I thought that had to do with a reduction of benefit.

And are we trying to kind of address the reduction and modification of retiree health benefits through these words, or is that someplace else?

MR. BRANAN: No, we're speaking of pooling and depooling.

In Orange County, for example, the decision of the Board of Supervisors, in a series of steps, leads to the depooling of actives and retirees.

The retirees, there is no retiree pool being formed. They're out on the individual insurance market.

MR. PRINGLE: Well, so you have picked just the fact that they are out on the individual retiree health-care market as being depooled as opposed to repooled.

And reading this, it sounds to me like you're talking about how to shift and create two separate pools -- at least that's what John was suggesting. But I actually think the fundamental of this discussion, if I'm on the same page as you, is to talk about what do you do with retiree health benefits under the context of, you know, commitments and cost savings and those types of issues.

And I think if we talked about that more directly, I'd feel more comfortable about it, as opposed to just somehow focusing only on this pooling concept as the principle of how you save money or how you shift that obligation from retirees through their individual pooling away from the active employees.

I mean, I would much rather have some discussion specifically about a recommendation that talks about eliminating that benefit after there was some degree of commitment, where retirees felt there was that degree of commitment. I would much rather have that discussion than to say that the full context of retiree health benefit is a repooling concept which, to me, isn't what happened in Orange County. It could have been, but it isn't.

So here, we're focusing on this probably in response to some of that Orange County stuff and to address some retirees' concerns. But I think it kind of misses the mark and that's what's kind of throwing me off a little bit on this whole discussion.

MR. COGAN: Let me explain why I raised it. It seems to me that when we discuss this issue, the question before us is: Do we wish to make a recommendation that current workers subsidize current retirees? If we make that judgment, then we would recommend putting them in the same pool. But there's no societal gain. And what was worrying me about this discussion is, the discussion starts out with some discussion about a societal gain coming from risks being pooled together and thereby the overall risks that people are incurring in our society is falling; and that's not so.

This question ultimately comes down to one of subsidies. And that was the only point that I want to make. And I think you're right for wanting to focus on it.

MR. PRINGLE: The subsidy is not just defined as separating two pools, right, taking one pool with actives and retirees and separating them, therefore, you eliminate that cost-shift.

MR. COGAN: Right.

MR. PRINGLE: That is what we're talking about here. But that subsidy could have that a lot of other ways. For example, how much money we're putting aside for retiree health, but what plan we're paying for, what percentage of that plan.

MR. COGAN: Sure.

MR. PRINGLE: All of that is what governments are deciding with that retiree class.

And my question here, all we're talking about here, is the pooling element of that is somehow being the sum and total of all of that shifting or contribution for retiree health. And I think it's a bigger issue than just are they in separate pools or a single pool. Therefore, I would probably have a hard time saying that we should be making a recommendation that says specifically we should keep the pools together.

I don't necessarily want to make that recommendation.

CHAIR PARSKY: Okay, Bob?

MR. WALTON: Several comments.

First, I think using the distinction between "active" and "retired" is an easy distinction, but it's really misleading.

Insurance costs are based on the enrollee’s age. And a 60-year-old active member is more expensive than a 52-year-old retired member. So the fact here, active or retired overall is clear, but individually, it's not. And so it's age-based. And I think the older your group is, the more it's going to cost. Whether they're active or retired is not relevant.

I think the nature of any insurance pool is cross-subsidization, to some extent. I would argue that unhealthy lives are cross-subsidized by the healthy lives. Within California, at least, those in the rural area are subsidized by those in the urban area.

And the difficulty, you start down a path of breaking up your pools, where does it end?

I think size does matter. I would agree that at a point, that a pool becomes so large, the actual benefit pay-out risk diminishes.

On the other hand, from the administration standpoint and the ability to influence the market shouldn't be ignored. There, the larger pool, the more influence you're going to have on the market, whether it's active or retired. Bigger is better, regardless of who is included in that pool.

I think it's important -- and I would like to see this commission make a recommendation that it's in everyone's best interest for people to be covered within an insurance pool. Whether they're active or retired, again, is not that relevant to me. And anything that will lead to that result is better than something that will lead to a result where people aren't covered by insurance.

The uninsured are costing us a lot of money. And we, the insured, are cross-subsidizing that amount.

And so I look at this a little differently. I don't look at it as active versus retiree. I look at it as a pool. The larger the pool, the more influence you're going to have in a market. And, yes, by its very nature, you're going to have cross-subsidization between various groups within that pool.

CHAIR PARSKY: Teresa?

DR. GHILARDUCCI: No.

CHAIR PARSKY: Lee?

MR. LIPPS: Tom, is some of this motivated by the requirement under GASB 43 for public agencies to now report its implicit subsidy rate and perhaps a resulting temptation for public agencies then to want to charge differing rates between the retiree pool and the active pool?

MR. BRANAN: I do think that the arrival of 43 and 45 precipitated some employers' movement towards depooling, yes.

MR. LIPPS: Thank you.

But that is a requirement, reporting that?

MR. BRANAN: To reporting it.

MR. LIPPS: I think it's under GASB 43.

CHAIR PARSKY: Tom, maybe to some extent, it's a little bit confusing, was because the heading of the subject matter would seem to suggest that the Commission should consider how to deal with increased access by retirees to pools. That's what the heading would suggest. But the text of the recommendation seems to go in a different direction.

So what did you really have in mind as you were putting those two things forward?

MR. BRANAN: What I had in mind was that the Commission should recognize the value of keeping actives and retireds together in a risk pool.

CHAIR PARSKY: But that was aimed at assisting, whether you call it subsidy or otherwise, retirees who might be, quote, on their own?

MR. BRANAN: That's correct. And not -- it would be an ongoing process, so that those actives who are currently paying more to subsidizing retirees would, in turn, benefit from the same arrangement.

CHAIR PARSKY: That is understood.

Okay, I just wanted to kind of make clear what the orientation is. I'm not sure it's going to be acceptable, but okay.

Jim?

MR. HARD: Yes, to follow up on something Bob said, that the size of pools and the leverage in the market. It's interesting that the discussion is about active employees subsidizing retirees.

Now, I believe there are still some active employees who have their health care 100 percent paid, in which case if there is retirees, it really isn't the active employee subsidizing, unless you want to get really indirect and say, "Well, because it's getting more money there, they didn't get more money in wages," or whatever.

And I wonder if there is, in fact, any data that the insurance corporations actually, you know, have a different -- that the difference in price is in proportion to the cost, actually, of elderly people, the age in their medical costs. Because it seems to me that what I saw Blue Cross just this year, was billions of dollars in profits. So I'm just wondering, really, is there a direct -- do you have data that shows there's a direct relationship between the cost for the more aged population and the younger population? And does it work out that way for the cost directly?

Or, in fact, are corporate profits, and the market and the oligopoly in health care, does that have anything to do with the price, or is it all just based on risk?

MR. BRANAN: Well, taking your first question first, I think there is lots of data available showing that an older population requires more health care --

MR. HARD: Absolutely.

MR. BRANAN: -- and, therefore, would cost more than a younger, healthier group.

MR. HARD: I understand it costs more, I got that.

Does it really translate into the same proportion and the difference in price to employers?

MR. BRANAN: That, I don't know.

One second.

MR. BRANAN *(to Mr. Krolak):* Are you aware of anything?

This is Richard Krolak.

MR. KROLAK: I'll talk loud.

There it is. Thank you.

As Tom has indicated, I think there is significant evidence that indicates that an older population uses more services, higher utilization, therefore, higher costs. Clearly, those costs get translated -- and I'm going to use a slightly different term -- into premium that an employer and employee pay.

Now, some of those other items that you mentioned -- and, correct -- you know, margin is always added on to cost, and that becomes your totality of premium. And so there is that relationship.

Now, the degree of that margin we could argue about all day, and it depends on a number of things.

But, yes, there is certainly a relationship between an older population utilizing more services, therefore, it being more costly, particularly if the kinds of services they use tend to be different. So it's higher utilization and utilization of a particular mix of services.

But I'm not sure that that really addresses your specific -- that's sort of a last piece, which is I think beyond the scope of this discussion, and clearly gets into the whole issue of what's an appropriate margin, you know, marketing versus underwriting costs versus profit and so on and so on and so on.

MR. HARD: Well, if we’re concerned about the cost to public employers, I don't think it's beyond the interest of this commission. But, you know, if we're not --

MR. KROLAK: Not the interest, but the --

MR. HARD: But if we're just interested in the split between the retirees and active employees, then right, we can just stick to that.

CHAIR PARSKY: Teresa?

DR. GHILARDUCCI: Well, I think the real juicy information is going to be about the savings you get when you make PEMHCA, or any other California public employer the secondary payer --

MR. KROLAK: Right.

DR. GHILARDUCCI: -- when you have Medicare eligible retirees.

So, in fact, what John said may not be quite true if actually the retirees are Medicare-eligible and they come in and, in fact, they're much cheaper than older active employees.

And I also want to point out that in our background material, Tom did mention that pooling two large groups has an advantage, not just because of spreading the risk and getting that benefit -- and it could be negligible, I think John's points are correct -- but you get the extra added bargaining power when you're contracting for services; and also you didn't talk about the idea that you actually get premium smoothing. You get more stable costs.

In fact, I think what you assert here stands: That putting retirees and actives together actually may make economic sense, a cost reduction; and that it makes these other dynamics lead the way to actually having some advantages. So I think it stands.

CHAIR PARSKY: John?

MR. COGAN: Let me see if I can cut to the chase here on the question that the Commission has to address.

Is it the case that if we were to recommend that retirees and active employees end up in the same pool, right, that it would be the case that for those that are not in the same pool now, that the costs would go up for the current workers and go down for the current retirees?

MR. BRANAN: If they were pooled together?

CHAIR PARSKY: You mean, if they came into the pool?

MR. BRANAN: I think that's the assumption, yes.

MR. COGAN: That's the general rule.

So I guess my point is that that has nothing to do with risk. It has everything to do with the expected costs of older individuals versus younger individuals. And it seems to me that we're being asked to make now a value judgment about local benefit packages, and are they fair for older workers or retirees versus workers. And it seems to me it's a place where we don't want to go.

Who are we to say that a particular package that has been negotiated between labor and management is treating -- because of one element -- is treating one group unfairly relative to another?

So I sort of see it as one of these areas that the bottom line is, there's no societal gain; it's all whether we want to recommend a transfer from one group in society to another, one group of employees to a group of retirees. And it seems like it's a bad place to go.

CHAIR PARSKY: Dave?

MR. LOW: I have a question.

To my knowledge, not very many agencies have depooled and separated their retirees from their actives. From my experience, the absolute vast majority of them are pooled now.

Do you have any data or information with regard to how many are separate and how many are together now?

MR. BRANAN: No, I don't think so.

Have you seen that?

MR. PALMER: No.

MR. BRANAN: No, we don't.

CHAIR PARSKY: Well, how would the rest of the Commission feel about, really, John's comment? Inherent in John's comment is that trying to keep this as part of our recommendations is really a move toward making a social judgment, if you will. And, and it's not something that this Commission should try to address.

Okay, let's go around again.

Lee?

MR. LIPPS: It seems to me that a

recommendation along these lines, should we make one, would more fall into the area of best practices, in that if there were benefits to remaining one large pool, then agencies should consider it. If there were not benefits, then either they don't have to consider it or they can consider it and reject it.

But I think this is more in the area of best practices than --

CHAIR PARSKY: Yes, but if you build off of what John said, I mean, it's very conceivable that through the collective bargaining process, at one level or not, there could be a policy decision that retirees should receive the benefits or the subsidy from existing employees under a program that keeps them together.

On the other hand, it may be for a variety of reasons that that's not the case with any number of other authorities.

So I'm not quite sure that there can be one policy that necessarily will fit all of the authorities.

Bob?

MR. WALTON: Yes, I guess what I'm struggling with –- well, there are several aspects of it. I think most importantly on what we've just discussed, the fact is that retirees aren't represented in bargaining. They don't have a stake. They're not in that process. And if they were, it would certainly be more fair and equitable to have something along those lines, but they're not. And so they're left out of this process when this decision is made, and so I have difficulty with that.

I still go back to my original thought process, which is that it's better for people to be in insurance pools than to have them out of insurance pools. Whether you break up active and retired.

If you just look at breaking up active and retired, theoretically, the cost is the same, you're just paying for it differently. Theoretically. In actual practice, it may be a little different.

But what I'm concerned about is what Orange County did is, you cover your actives and you kick your retirees out all together and not leave them in any risk pool. And I think from an efficiency of government, if nothing else, it's cost-effective to have retirees in an insurance risk pool.

CHAIR PARSKY: Whether that pool includes existing or not?

MR. WALTON: Whether it does or not.

DR. GHILARDUCCI: Rather than on Medicare.

MR. WALTON: I think it's better for them if they're in, because I think there's economies of scale, the impact on the market, your influence, that sort of thing. But nevertheless, the bottom line is, are they within an insurance pool? Do they have access to an insurance pool, as a bottom line, as opposed to being left on their own.

CHAIR PARSKY: Curt?

MR. PRINGLE: I actually think the heading here, Mr. Chairman, as you pointed out, should have gotten us closer to that point and getting us focused on separation of actives and retirees. I mean, should we have a recommendation as to elements that we would recommend to various pension funds to create pools by which retirees can participate. I mean, that is -- I think that's where we all probably could agree, that there is greater value in that system if, in fact, there was access to risk pools for retirees, not necessarily making the value judgment as to who should pay or should we shift from actives to retirees and that issue. But just should we make a recommendation that there needs to be ease of access for retirees.

CHAIR PARSKY: For retirees.

Lee?

MR. LIPPS: I just don't want to lose sight of the fact -- let me go back.

Bob is correct, that theoretically, whether you separate the pools or not, the cost is the same. But I don't think we should lose sight of the fact that if both active -- if the employer contribution for both active employees and retired employees is capped at a certain level, once you split the pools, you could have the active employees paying far less out-of-pocket for the coverage than the retirees who will have their out-of-pocket perhaps substantially increased.

Now, I'm not making a judgment on that one way or the other. I'm just saying, we need to keep sight of that fact in any kind of recommendation that we might make.

CHAIR PARSKY: Dave?

MR. LOW: I think they're both right on here. And the issue with pooling is really stabilization of costs, not -- and there is a cost-shift when you pool the retirees together. And I'm a firm believer in pooling, because I believe that part of the whole issue that we're trying to deal with here is cost to employers. And it's not just the amount of the cost, but it's providing employers and workers a predictable, stable cost that they can fund over time.

So, you know, maybe the issue is bigger than retirees being carved out of pools or put into pools. But just the concept that pools are better -- bigger pools are better than smaller pools, because the bigger they are, the more people and the more lives you have, the more you spread the risk, and the more stable the cost. So maybe we can agree on that broader concept as opposed to focusing on this issue of carving retirees out.

CHAIR PARSKY: Yes?

MR. COTTINGHAM: I agree with Dave on that.

And I think -- I'm sorry, I had to step out of the room for a minute, but I don't know if anybody asked this or brought it up, but I think probably the largest pool in this state and the third largest in the nation is CalPERS. And I think CalPERS, as opposed to other systems, has kept the retirees and their actives together. And I think that they have -- and maybe that's something staff could do is check with CalPERS, because I believe they have looked at the ongoing cost of keeping that pool together, and they have made a determination on the benefits of either separating them or keeping them together.

And I am of the opinion right now that they have looked at it and decided that it is an insignificant cost to separate your retirees out so they're keeping them pooled.

Each system that you can look at in California that has divested themselves or separated the retirees out, it's because they're smaller pools, and they don't have the bargaining power. And that's where they lack the impetus to really lower costs, either to their employees that have retired or to the employer that's helping to pay the cost. So I think that's -- but I think CalPERS is an area that we can look at as where large pooling bringing together, I think, has helped to contain the cost.

CHAIR PARSKY: Well, maybe -- John?

MR. COGAN: One final point.

I like the idea of recasting the issue and getting it away from retirees versus active workers. And I think it's really important to do so.

There are a lot of proposals that could come before this Commission that pit active workers against retirees. And my judgment is, we should stay away from them.

I mean, I could imagine a proposal that says, "Well, gee, we've got benefits that were granted retroactively, so why not take away those benefits that were granted retroactively a few years ago and put the savings in a health-care fund for existing workers?"

Now, there's a concrete proposal that's been on the -- it's very divisive. And I don't think this commission should be going in that direction, and I don't think it should be going, therefore, with this notion of pitting actives and retirees against one another, which I think the proposal, as stated, does.

I'd be very comfortable with an alternative that dealt somehow with providing a pooling -- a more efficient pooling arrangement.

There is a pool out there for workers, for retirees. It's not that there's no pool out there. There are private-insurance companies that offer insurance. They have pools. They're the insurance agent in this.

So if there's a more efficient way to provide that insurance, great; but I'm not sure that there is.

CHAIR PARSKY: Well, maybe two underlying concepts. Again, I think this one we may want to bracket a little bit stronger than others because we want to see how -- but one concept is to put forward some indication of the benefits of pooling, or of a larger pool, just overall. Stay away from differentiating "active" from "retiree" but focus on policies that would give retirees access to a pool as opposed to being on their own. Not necessarily the pool that existing employees may be a part of.

Maybe there's some thoughts along those lines that would allow us to address retiree access. Does that seem to -- let's see if we can get some things along that line, Tom.

MR. BRANAN: Okay.

CHAIR PARSKY: Okay, the next subject for us ––

Oh, hold on. We have current Commissioners access here that we're worried about. Hold on.

Okay, last subject for today, Tom, *Medicare Eligibility and Coordination*.

MR. BRANAN: Our initial statement is: Medicare coordination requires that when individuals are eligible for Medicare, they are moved out of the employer's basic plan and enrolled in Medicare and possibly a Medicare supplement plan.

A potential discovery is that: Some public agencies allow Medicare eligible employees or retirees to remain in “basic” health plans. It is the legal responsibility of the federal government to provide medical benefits for Medicare-eligible individuals.

Employer coordination with Medicare helps to stabilize health plan rates and shifts costs to the appropriate payer, Medicare.

CHAIR PARSKY: Don't quibble over the words on that -- what did you call that? Not a "finding," what did you call it?

MR. BRANAN: A discovery.

CHAIR PARSKY: A discovery. You're moving in the right direction. Okay.

Focus in more heavily on the recommendations.

Go ahead.

MR. BRANAN: We have two recommendations.

Number 1: At the state level, legislation should be introduced requiring that Medicare-eligible retirees be transferred from the basic plan and into Medicare and possibly a Medicare supplement plan.

Number 2: Regardless of any employer contribution provided for retiree health care, local agencies should be encouraged to coordinate Medicare eligibility and to move eligible retirees out of the basic plan and into Medicare and possibly a Medicare supplement.

So there are two recommendations dealing with the two levels of government: State government and local government.

CHAIR PARSKY: Okay, Lee?

MR. LIPPS: Just to anticipate Curt on this --

CHAIR PARSKY: Oh, you know we had him out of the room for a while.

MR. PRINGLE: Local control is very important.

MR. LIPPS: Except for the things you would like to mandate.

Tom, it's my assumption that your intent in this is that this only applied to local agencies, public agencies, that provide retiree medical benefits, not --

MR. BRANAN: That's correct. We're dealing with the situation as it exists.

MR. LIPPS: Okay, so if they don't offer them, we're not telling them that they have to do this?

MR. BRANAN: That's correct.

MR. LIPPS: Okay, thank you.

MR. WALTON: Tom or Richard, correct me, this is a requirement currently in PEMHCA, is it not?

MR. BRANAN: It's an internal requirement, yes.

MR. WALTON: No, I think it's a legal requirement. I think it's in law.

MR. BRANAN: I know it was introduced in the 1980s, but I don't --

MR. WALTON: I'm 99 percent sure it's there.

DR. GHILARDUCCI: It is, Dave?

MR. ELDER: They don't cancel your insurance if you don't sign up for Medicare.

MR. WALTON: It sounds like Dave speaks from experience. I'm not sure.

MR. KROLAK: If you're Medicare-eligible and you don't move, they'll cancel your basic.

MR. WALTON: And that's in law?

MR. DITHRIDGE: It's at least in regulations.

MR. WALTON: Which has the same effect?

MR. DITHRIDGE: It is the same thing.

CHAIR PARSKY: Are there other –- yes?

MR. CAPPITELLI: Just one other comment. This makes the assumption that health care is the same, whether it comes through Medicare or it comes through other means. And I'm not so sure that I would want to make that assumption.

CHAIR PARSKY: Well, maybe it's appropriate to introduce this by making that point.

DR. GHILARDUCCI: I don't understand it.

MR. WALTON: Your point, Paul, is that if I just have Medicare, that's not the same level of coverage as active employees have under the base plan in almost all cases.

MR. CAPPITELLI: Correct, I don't think we should make a broad statement that says that the two are identical. I'm not so sure that that's the case.

DR. GHILARDUCCI: That it complements --

MR. BRANAN: That's why we included in each statement, and possibly a Medicare supplement.

MR. CAPPITELLI: Supplement, yes, I would buy that, yes.

CHAIR PARSKY: Dave?

MR. LOW: Yes, I'd like to see that strengthened a little bit because I think that's a good point.

The fact is, if you have a fully-covered plan right now and you end up retiring, and you just automatically get transferred to Medicare without a supplement, you could be downgrading your health care substantially in some cases, compared to what you have now.

And again, I think we have to be very sensitive to the fact that some local bargaining agents may have decided to keep their plan because that's what they wanted, and made trade-offs in other areas. So I think we have to consider that.

CHAIR PARSKY: John?

MR. COGAN: I'm entirely with what Paul and David said. And I would add one thing. Although this is a commission for California, the transference of people to Medicare for all the taxpayers out there makes not a dime's worth of difference. We're just going to be paying it under the federal program as opposed to paying for the care under a state program.

MR. BRANAN: Well --

MR. COGAN: I see how it makes sense for the state as an employer.

MR. BRANAN: And individual employers.

MR. COGAN: In the context of this commission, we want to foist off liabilities on the federal government, that's a very sensible thing to do. But let's not lose sight of the fact that that's what we're doing.

MR. PRINGLE: Here, here.

CHAIR PARSKY: All right, do you want to put your federal government hat on?

MR. COTTINGHAM: Just a question about how would this relate to -- because we do have a group of employees out there, the pre-1986, that aren't paying anything into Medicare, and would not be eligible. And that's still a pretty large pool right now.

DR. GHILARDUCCI: Yes, that wouldn’t affect this group.

MR. BRANAN: These are people who are Medicare-eligible.

MR. COTTINGHAM: Okay, so you would still have an increased cost on the ones that are left in the pre-1986 era?

CHAIR PARSKY: Yes, you would.

MR. BRANAN: But that would not change. They are already out there. This is just for people who are Medicare-eligible and are not being put into a Medicare and Medicare supplement plan. Then there would be a cost savings on these people.

MR. COTTINGHAM: When you were looking at this, I mean, I think there are a number of systems that are doing this.

Do you have any idea, has anybody looked at that?

MR. BRANAN: Excuse me?

MR. COTTINGHAM: That there are a number of systems that have brought this concept in, that when you get Medicare eligibility and you are eligible, that you will be put in a supplement plan?

MR. BRANAN: Yes, we have looked at that. And I think there are PERS representatives in the audience that if you wanted more detail on how they do it, they could probably provide it.

MR. WALTON: About two years ago, maybe three years ago, there was a federal change -- Richard, correct where I get this wrong or if I come close -- if you have people that are eligible -- the more people you have in a supplemental plan, the employer gets money back from the federal government. Is that correct?

And that's why I think more of them are thinking, "Oh, gee, we don't want to leave people on the basic plan, because the more we get in the supplemental plan that are eligible" --

MR. COTTINGHAM: It has to do more with the Medicare Part D, I think.

MR. KROLAK: It's a combination of things. There's an employer subsidy for Medicare Part D, which is the pharmacy program. And there is also -- starting -- and I'm using your time-line -- two or three years ago the federal government began to provide greater reimbursements for Medicare Advantage plans, the managed-care plans. And, obviously, that's been in the news a lot lately.

So there were a couple of things that the federal government has done in the last two or three years that did change the reimbursement relationships and did provide some incentives.

CHAIR PARSKY: Okay, you have some guidance here, or do you need more?

MR. BRANAN: I think we're fine.

CHAIR PARSKY: Okay, that –- yes, Bob?

MR. WALTON: I apologize, and you're probably going to send me to the corner for this, but going back to the last subject, Lee said something --

MR. BRANAN: No, we can't do that.

MR. WALTON: -- and it triggered something. I think it may be a finding, an enhancement, an observation.

CHAIR PARSKY: Discovery.

MR. WALTON: Discovery? That's good. I like that.

If a public agency that currently has their active and retired in a pool for health benefits, if they split those pools, obviously the retiree pool is going to be more expensive. The premium for that group, given the same level of coverage, will be higher. Therefore, their GASB 43 and 45 liability will be higher when they split pools between active and retiree.

CHAIR PARSKY: Yes, that -- I think that is certainly worth pointing out.

It doesn't change the thrust that they were going to recommend.

MR. WALTON: No, it doesn't.

CHAIR PARSKY: Okay, that completes the discussion items for this subject.

And we have one more presentation that we moved to the afternoon; so I will ask our two panelists to come up, and we will try to be efficient about how we deal with this so we can complete our mission.

DR. GHILARDUCCI: Are we at 4, Mr. Parsky?

CHAIR PARSKY: Yes, 4. Yes, exactly.

Okay, if each of you could introduce yourself to the panel -- to the Commissioners, and then proceed.

MR. KEIL: My name is Steve Keil. I'm with the California State Association of Counties.

MR. STENBAKKEN: Dwight Stenbakken, League of California Cities.

MR. KEIL: We actually have two presentations to make today, and I'll start with the one that I think has been discussed with your commission the longest. It's accompanied by -- I hope you have a copy of a document that has been submitted by multiple employers and retirement representatives.

Dwight and I both are part of a group that the signatories include some California Special Districts Association, California State Association of Counties, County Auditors Association of California, the California State Department of Personnel Administration, League of California Cities, Regional Council of Rural Counties, the School Services of California, and the State Association of Retirement Systems.

I'll give you a little background as to how we got to this document that's before you. When we heard that your commission was first formed, some local agency representatives first met in an effort to try to basically sort out what was going to happen and try to be of some assistance.

Frankly, we’re very pleased early on that we didn't have to deal with fears. Rather frankly, there were respectable people appointed to this commission and a full-time staff that actually had an agenda.

Very early on, your staff met with us, I believe it was around January of this year, and asked for our assistance. At that time local agencies broadened the participation to include not just the signatories to this letter, but a number of other state representatives, as well as other agency representatives.

As far as I know, none are in opposition to the contents of this letter; but others, for various reasons, decided not to also add on as signatories.

The first thing that we did was we began trying to develop some data on utilization of the OPEB benefit. And we focused on that as the lowest common denominator of our mutual interest.

With the assistance of your staff, we actually helped create the format that you're using and try to encourage some input during the first several months of this year to try to collect data for that OPEB survey.

After that, we thought that, collectively, what we could also do was try to endorse a number of what we think to be tools that would be of value to public agencies in meeting their OPEB obligations.

I don't think there's anything in this list you haven't already heard about. We want to go on record to make sure you understand that we do endorse a number of ways in which, without actually advocating one way or the other on what should or should not be contained in an OPEB liability and practiced by local agencies to try to assist us in trying to sharpen some tools that will help us manage the obligations we now face.

Within that light, this letter has been submitted to you, and it consists of a letter identifying what we think are recommendations your commission could make that will be very helpful to us, along with a couple of draft letters that might be helpful in terms of trying to initiate that if you proceed ahead.

The first recommendation we make is that we think we all benefit from information. We think that the effort you're now making at trying to collect some statewide utilization information would be helpful to all of us to be able to identify what we're doing, how it compares to what other agencies are doing. And we think this effort ought to be an ongoing kind of a collection process.

Now, with that, our recommendation is that the appropriate person to make the actual recommendations on how it will work will be the State Controller. The State

Controller very clearly is the elected official who deals with local agencies in the state, in terms of collecting information on revenues and expenditures. It gets messier in the schools area. We're not clear how that would best work. Our schools colleagues think that perhaps the local superintendents, the county superintendents of education for school districts might be the most appropriate body, perhaps it's the elected superintendent of education. We don't really know. But we think the Controller could help give some guidance on how schools data could also be collected for some kind of a statewide process.

In terms of data, you'll note that the survey format you're using that we helped construct, is really the lowest common denominator data that we could think of how to collect data where there would be some consistency.

We have had experiences individually, among other agencies, of trying to get a much more sophisticated survey, and we end up with garbage, frankly. This is such a new issue to people, practices vary so widely, the semantics are so different from one agency to another, that when you get from our experience much beyond the issue of size of the employee population, size of retirees that might be participating, ongoing cash obligations, and perhaps the actual GASB 43/45 numbers, it becomes very difficult to see any way of getting consistency in information.

But we think that your experience this year will help really sharpen processes what realistically could be utilized for ongoing collection of data processes.

Also, we had been questioned, does this constitute a local reimbursable mandate? That issue will come up.

And the response I will suggest to you is this: One, it probably does. It probably is a low cost one. And, frankly, the state has been very successful in defeating our mandate claims and reducing them down to an obscenely low amount, anyway.

And this document will be the state's evidence that it's a local request, which is a reason for disclaimer of reimbursement under the Constitution. That issue will come up. I just didn't want to sandbag you with it when, in fact, it does down the road.

That's our first recommendation, but it's one that I think would be universally helpful to everyone to have better information.

The second has to do with –- recommendations 2 and 3 have to do with seeking clarification on our relationship with federal authorities for purposes of OPEB -- and particularly OPEB trusts.

The first one is a complicated one. We have a two-page draft letter attached. It has to do with federal participation in our payroll. I believe you've heard this issue before, but it's a very real one to the state, the counties, the schools, and to a lesser extent, to some cities and special districts.

In the counties, depending upon the county, as much as over half of our payroll originates from the federal government. It will vary by the state. I won't even hazard a guess as to what part of that comes from the federal government.

We have a huge concern that should we start because of a commitment in a local agency, an OPEB trust, and should we prefund that trust, we have concerns that the federal government may not honor the debt service on that trust.

You had what I thought was a very informed discussion earlier about the fact that it's very unclear whether, unlike retirement and workers' compensation, whether OPEB really is a vested obligation to begin with.

And a legitimate question particularly facing what's happening nationally, the feds are going to ask is, why should they pay for something that isn't a vested obligation?

At the local level, we ran into this a couple of years ago in dealing with the federal government on pension obligation bonds. They're very willing to pay on a pay-as-you-go for debt service for pension, but they balked at paying even though the collective cost was lower, the debt service on our pension-obligation bonds. And the State Controller and our auditors were successful in negotiating with the Office of Management and Budget, a process in which we could, in fact, get guaranteed payment from the federal government if we could assure that the total cost of the debt service was less than what would have been paid had we not gone through that pension-obligation bond, essentially.

It's a little more complicated given the vesting issues with OPEB and given the political dynamics of how much money the federal government is going to be looking at in upcoming years. But we think that trying to get some kind of assurances from the federal government under what circumstances they would be willing to continue their obligations for payroll costs, payroll cost-sharing under these OPEB obligations will make it a lot clearer and perhaps easier for those agencies who do wish to prefund, where they plan individually to undertake as an ongoing obligation.

I'll try to expedite things. Number 3, very similar. It's very unclear to our people what kinds of tools exist for purposes of being able to prefund our various OPEB obligations. We know that they're in the tax codes; but, frankly, we're novices at this stuff and we're terrified of it, collectively and individually. It will be most useful if we could get some kind of a letter ruling on various types of IRC vehicles for investment for funding and prefunding obligations that will be available and under what circumstances they would be available.

For purposes of recommendation number 4 through recommendation number 5, this has to do with the issue of debt service. Remember, of course, that what complicates our OPEBs is the uncertainty about whether they're a vested obligation. Nevertheless, one of our concerns our public agencies have is, if they undertake an aggressive program of prefunding their OPEB obligations, such as through some kind of an indebtedness of process, what happens if a couple years down the road something radically changes? For example, this last week I have been totally preoccupied with health-care reform here in California. I don't think it affects OPEB from anything I'm seeing, but it might, the way things are evolving. Very likely, this is going to stimulate and help pursue the national debate on health-care reform.

In it, for example, an agency with a billion dollar OPEB liability decides to go out and prefund it at the 50 percentile level, and then four years down the road, we have some kind of a major change in national health policy that would make that not necessary, the concern we have is, under current arrangements in state law, we don't think we can use those OPEB trust monies to pay off the debt service. And this could be very useful if for the singular purpose of penetrating that trust to pay out debt service. Even with contingencies due to some kind of significant change and utilization need we think would be very useful for us, that also would require us to go back and request that the GASB people modify their instructions in order to identify this as allowable under trust standards.

Our recommendation numbers 6 through 9 really are just informational areas we think your commission to be particularly helpful to us. Again, keeping in mind, our public agencies had no idea OPEBs even existed until the middle of 2005. We're just -- we had our first training at the local agency level, at the beginning of 2006. This is a new thing to us. And people really are nervous about what kinds of tools they have, what kinds of options they have, what they should do, even now. And we think that number 6 is what I think your staff is referring to as “OPEB for Dummies.” Something out there just basically saying, "Here, from an official body, not a vendor with some product to sell, from an official body, is what your obligations are, and here's where you go to get more information about them." It will be most useful.

Secondly, it would be to provide information that we've already referred to; but that would include, for example, what kinds of debt service. If an agency chooses to prefund and chooses to go out and try to capture current low interest rates, what kind of debt to service options are allowable under California state law?

Also, the next one would be what kinds of investment vehicles are out there? This relates back to the letter we're recommending you request from the IRS about what are allowable ways we can try to prefund some of these benefits.

Our final recommendation is the one that comes closest to what I think might even be viewed as controversial on this list -- and, I'm sorry, the ninth one does. That has to do with best practices. You used that term earlier.

We are not suggesting that the Commission take a position on best practices.

What we are suggesting, though, is it would be very useful to have a chronicle of what are people doing to try to either perpetuate or to control costs with the issues of OPEB benefits, and what are some of the pros and cons? I've taken the position, not an advocacy statement of pros and cons, you just today talked about pooling, vesting, and Medicare coordination for example. There's a lot of others that could go on that list, but we think that official kind of document would be useful.

And the final item that we recommend to you deals with bankruptcy. Very unclear what the status is of a public agency, should there be a bankruptcy. We saw a lot of that come out of the Orange -- the near-bankruptcy situation Orange County faced several years ago. We are advised that state law does not protect OPEB trusts from the creditors of a public agency should there be a bankruptcy. We think that that is something that we should seek clarification for in state law to make that inviolate in the event of a bankruptcy on a local agency.

That's the recommendations we bring forward. They are a consensus of all the signatories to this.

And I'll stop here.

Dwight, of course, has been very active in this, as have the others, and try to answer questions before going on to our next item.

CHAIR PARSKY: Why don't we just pause here and see if there are questions of Steve, and then we'll move to Dwight?

(No audible response)

CHAIR PARSKY: Okay, Dwight, go ahead.

MR. STENBAKKEN: Thank you, Mr. Chairman, Members.

We were on your schedule earlier in the year; but due to some scheduling problems that you had at that time, we deferred. And we appreciate the time to be here today.

The League and CSAC also went through the retirement issue and the rising costs in deciding what to do as organizations to try and deal with these issues. And both organizations came up with roughly the same recommendations.

But very quickly, I want to go through some of that with you and exactly how we arrived at that.

We wanted to take a look at our retirement systems and make a decision as to what role the retirement system played in our employment process. And not surprising, we think it's a critical piece in recruiting and retaining employees, in which you've talked about here.

What we wanted to do, is to get some actuarial help with us. And we did that. I've submitted some materials -- it's in your packet -- that we used to back up some of our recommendations in the retirement area.

And what we did in that process is that we wanted to take a look at what was an appropriate retirement level that provided a fair retirement that maintained the retiree's standard of living in retirement for a career employee. A “career employee” being defined as being somebody with 30 years of public service.

We looked at two models. One was done by PERS, the other was done by Georgia State University, I guess a known actuarial school, and looked at the replacement rate -- the appropriate replacement ratio to achieve those goals of a fair retirement for a career employee that maintained their standard of living in retirement.

When we looked at that and then looked at some possible formulas that would fit in within that replacement ratio -- and that replacement ratio was some place in that 65 percent to 80 percent range -- when we looked at the retirement formulas that would be appropriate for that and it would meet that range, we recommended a couple of them. One for public safety is a 3 percent at 55 formula, not really too different from the old 2 percent at 50. And what was happening with the public safety employees, usually postponed retirement. And so the experience was that they were retiring closer to 55 and were getting some place -- a 2.7 percent formula.

So, anyway, 3 at 55 for public safety, 2 at 55 for miscellaneous employees.

When we also looked at those two studies and then compared the new formulas that were inactive within SB 400, and I believe the other number was AB 616, we found that those benefits levels were well above that 65 to 80 percent replacement ratio.

And so what our recommendations are, is that we should, for new hires, look at going at a different tier of retirement benefits, something that fits within that replacement ratio that we did in our actuarial work.

So to kind of summarize everything quickly here, we still believe in a defined benefit plan. We think that's been a good plan. It has been successful for nearly 60 years in recruiting and retaining the quality workforce.

Number 2, we're not into the "we're going broke" school, because we don't think we are going broke by all the standards that you've been looking at here and trying to evaluate that question for retirement systems.

Perhaps there could be some questions raised as to what level of public services are we forgoing as a result of paying for these higher costs? But I don't think we're in the -- we’re not in the "we're going broke" camp.

And what we do believe is that in addition to looking at a retirement system that is fair for a career employee that maintains their standard of living in retirement, that a key element that our folks felt very strongly about was that it should also be defensible in a public arena.

And our task force and board that worked on this felt as though the new benefit formulas are going to be difficult to defend in a public arena. And we are concerned that somebody is going to take the initiative route and put something on the ballot that isn't going to be good for public retirement, public service, in total.

So the last recommendation is that we would hope that labor and management could come together and try and deal with this ahead of the curve rather than something coming up that somebody puts on the ballot and we'll all have to deal with it.

So very quickly, those are our recommendations on the retirement area. They are roughly similar to what CSAC also did in that area. And we've submitted materials. And we thank you again for the time on your agenda.

CHAIR PARSKY: Thank you very much.

I apologize for the administrative arrangements, but we really appreciate your input and all of the data that's been provided.

We're going to take into account all of these recommendations.

I just mentioned that at our next hearing, the tax area is going to be addressed so, Tom, we'll try to take all this into account.

Questions?

MR. CAPPITELLI: Yes.

CHAIR PARSKY: Paul?

MR. CAPPITELLI: Yes. First of all, I want to commend you. I think a number of your recommendations here are right on point, and I think you did a great job of putting this together and it will be helpful to the Commission. So thank you for that.

I did have a quick question. There were a couple of areas that I found to be a little bit contradictory, and let me explain.

There is a lot of reference in here about being concerned about creating more than one tier when it comes to these types of retirement systems. But I get a little nervous when you start talking terms like "roll back" and "repeal." And then more importantly on that same issue is, when we talk about the importance of proper actuarial work and the like, but yet we say that we recommend that we roll back to a particular percentage and a formula, to me, those two things are somewhat contradictory, because I think all the evidence that we've been presented with suggests that if you have proper actuarial calculations in the funding, then the percentage really doesn't matter. And so I was wondering if you could maybe perhaps clarify for me exactly how you came up with these recommendations for these percentages here?

MR. STENBAKKEN: Again, we went back, and they were based upon the two models that were done, one by PERS, one by Georgia State. And that's included in the materials.

And then what we looked at and tried to match, were retirement benefit formulas that would place us someplace in the range of the recommendations by those two studies to provide a fair retirement for a career employee that maintained their standard of living in employment. So that's how we did that. And we tried to match a formula that fit with that replacement ratio, or those replacement ratios, as opposed to something else.

The reference to formulas being done without any -- without the same kind of actuarial basis, I think you had this discussion a little earlier today, that some of the formulas that were enacted later in the process don't really have a rationale for incentives for early retirement or staying on longer, that have some actuarial basis to it, or a more questionable actuarial basis to it. So that's kind of where that reference came from, and that's how we came up with the recommendations.

MR. CAPPITELLI: Okay, I understand that. But specifically for the words “roll back” and “repeal,” can you explain to me what you mean by that?

MR. STENBAKKEN: What we are proposing is a new tier of retirement benefits that would be open after a date certain to public employees in California.

And we have our recommendations. It would probably look an awful lot like it was before SB 400, to be quite honest.

MR. CAPPITELLI: And would that be prospective then?

MR. STENBAKKEN: Prospective, correct.

MR. CAPPITELLI: Okay, thank you.

CHAIR PARSKY: Curt?

MR. PRINGLE: Yes, thank you, Mr. Chairman.

I think all you've done, Paul, is highlighted the schizophrenia of the League, as they serve multiple agencies and try to maintain that level of balance and come up with some very good recommendations. I'd like them all, even those that contradict each other.

MR. STENBAKKEN: Thank you.

MR. PRINGLE: And there's good recommendation, maintain --

CHAIR PARSKY: He's used to dealing with contradictions. Don't worry about it.

MR. PRINGLE: -- “Maintain the defined benefit plan as the central pension plan for public employees in California.” At the same time under the list, it says, "Provide alternatives to the defined benefit plan for job classification not intended for career public service employees."

And, you know, I do think that those sound, on their face, somewhat contradictory. But we know how they can be applied. And I appreciate showing that there are the abilities to address those that understand that this is the system that's in place for virtually every agency, at least on a pension side in California. But there are also jobs and careers and places where alternatives need to at least be allowed to sneak in or to express themselves.

And I think this is the first time you kind of see that fluidity within one set of recommendations. And, I mean, I think it's somewhat encouraging.

I do probably, Dwight, question one line, and I'd probably ask you to contemplate changing it. And that is on the last bullet under "Pension Benefit Levels," on page 2, "Promote career public service without creating incentives to work past retirement age, nor disincentives to early retirement."

And I don't know why the League or any employer, if, in fact, an employee and an employer wanted to continue a relationship, why you would want to -- where you would not want to create an incentive to have an employee stay until retirement age. I think that's actually a good thing in some senses, and I think that's one of the challenges with our present retirement system and pension system that we may want to look at, is how do we encourage some employees to stay beyond that, quote, "established retirement age," wherever it may be established, and how do we make it worthwhile to the employee at the same time?

So I don't necessarily know if that should be a stated principle. And maybe at a later date, we can talk about why that is there and really what you meant behind that.

MR. STENBAKKEN: Okay, all right.

MR. PRINGLE: But I do want to suggest that -- what you see in some of this stuff -- I know I've been gently jabbed at under the context of a local elected official accepting the fact there are mandates.

There are only tens of thousands of mandates of local government in California today; and everyone who authored those in the Legislature thought they were a good idea.

And the pension system run by PERS has a set of mandates as to those public entities in which they want to use a CalPERS system.

We live within a set of options, and those are all we get. We can petition and try to expand that list of options, but that's what we get.

So when you have representatives coming forward that represent local governments who have spent a lot of time arguing against the state telling local governments what to do, understanding that it is okay because it happens all the time, every single day, in every single legislature, hundreds of bills that say these are best practices that the Legislature sees through a cooperative effort, we've come together, and we say, "And we want to make sure those good cities and those bad, those good counties and those bad, live by a set of defined principles; and it's okay to have mandates." I think that's what we see from both these gentlemen and their recommendations, that virtually all of them are mandates by the state that would be mandates upon their membership; and they don't feel that that's a bad thing, even though in every other case, when they don't like the mandate they'll complain about it. Here, they see there's value in presenting this for the betterment of, you know, OPEB benefits as well as pension benefits.

And I think it's a very proper place to be; and I'm glad that you were able to present these ideas because these recommendations I think, hopefully, many of which will be a part of our final report.

MR. STENBAKKEN: Yes, the distinction is mandates and righteous mandates.

CHAIR PARSKY: Teresa?

DR. GHILARDUCCI: I appreciate your list of recommendations, too. Just knowing how many issues we have to deal with, I can see how much work there was just plowing through every level of issue.

Let's talk about the proper benefit formula, because very early on we got testimony that improving the formula -- I guess it was SB 400?

MR. STENBAKKEN: Yes.

DR. GHILARDUCCI: Is that right?

Okay -- did not cause any deleterious funding effect in CalPERS. We had a lot of testimony that that wasn't what caused the funding shortfall; and, therefore, there was no justification that was implied that we roll it back.

Here, you're bringing up another justification to roll it back, and that is that it gives it too generous of a benefit. And you base that suggestion on these replacement rate studies.

And I was really eager to look at that, because I care about adequacy, too. And that's been sort of a subtext here that really hasn't been explicitly dealt with. But your replacement-rate study is fairly old. And there's been a near cottage industry of replacement-rate studies at the academic level and the think-tank level and the for-profit level. The Securities and Exchange Association just did one in 2007, one at the New York University, one at Boston College, one among the Society of Actuaries, that is beginning to think that our thinking that that 65 to 80 percent replacement rate that had been the target level ever since the “Leave It to Beaver Age” is actually just wrong. That because of the increase in cost be in health care, mainly, and because of the decrease in equity in people's houses, that the proper replacement rate is somewhere around a hundred percent.

And, therefore, if you want to come to us and to argue about rolling back the benefits, it probably has to be on a better basis than these replacement-rate studies.

MR. STENBAKKEN: Yes. Well, as you can see, these recommendations were made in March of 2005. Those were the studies that we used at the time, and it possibly does need to -- we probably are ready to take a look at that again.

DR. GHILARDUCCI: Yes.

MR. KEIL: May I just add a comment to this? Dwight has led on this because the League's work on this was more sophisticated than ours. Ours was pretty crude, but very much paralleled the work that the League was doing.

You recall in the year 2005, the defined benefit plan survived a near-death experience in this state. It was a horrible time in terms of there being really a division between those that wanted to replace our entire defined benefit plans with defined contribution plans. And we kind of found ourselves as being the only two people in the middle on that thing.

And it was kind of an interesting time for us, in that like everyone else, we were shaken by a number of events that we had to spend a little time analyzing how in the heck did this happen, or how did we get caught in this without seeing it coming?

And what we perceived was that, generally, the defined benefit plans were placed into law in the 1930's. And that was because Social Security did not permit public agencies to participate. That's when PERS was created, that's when our 1937 Act system was created. We have separate pension law that predated that. But generally, they were revised afterwards to model PERS and the 1937 Act.

And for 60 years, they went along famously without any kind of controversy. And the question became: What in the world happened? And the conclusions we drew, without the analysis that the League went through, was that it was a few factors.

The first one was a good thing, and that was the 1980's -- I think it was '81 -- the state Constitution was amended to permit our defined benefit plans to aggressively invest their portfolios. And so instead of having only 20 percent of their investments locked up in -- or open for purposes of equity investments, now we see more typically 50, 60, 70 percent going into that kind of a market.

Long run: Huge advantage because we got a lot more overtime investment dollars coming out of that process.

Two bad things happened because of that, though, inadvertently: Number one, we had just a roller coaster of good years and bad years and never developed the actuarial tools to deal effectively with that process. We're just now beginning to try to implement some that may help us over time.

The second one was plain, old greed. We had public agencies in the good years, wanting not to make any payments, never forgetting that there would be something after that. And we had employees wanting to have something like profit-sharing coming out of those retirement plans. And we saw substantial improvements in benefits over that next couple of decades of substantial investment returns.

The second thing that happened was the demographics. You've heard a lot of stories about that. I won't burden you with that.

The third thing is a whole changing political attitude that we now live in. And the result was a crisis that was nearly cataclysmic in 2005. It was the first time ever we had supervisors having to campaign on retirement systems, as we move forward on this issue.

The simple conclusion we came to without this analysis was that we had to make some changes. We had to find more consistency actuarially, and we think the pension systems have taken steps in that direction. But we also had to address the appetite of the taxpayers and the general public to deal with what they perceived, and we think correctly, as being very overly generous benefits.

We recognize that also on the positive side, that we want to maintain those defined benefit plans. We have career employees, we have professional employees who we want to keep in the workplace.

And what, from our perspective, we came back to, was that let's at least try prospectively protecting the constitutional rights of employees on the workforce, their current benefits. Let's go back to some kind of a statutory change that brings the available benefit configuration to something that we think we can survive amongst all those circumstances.

A very different approach the League came to, but independently we came up with almost the same results, which is where we debated the process during that 2005 year.

CHAIR PARSKY: Bob?

MR. WALTON: The difficulty -- and I was involved in doing some work at PERS on adequate benefits. And the difficulty is, it's very individual-based.

The fact is, if you come up with a percentage, it's going to be different for a lower-compensated person than from a higher-compensated. Certainly a lower-compensated person is going to need close to 100 percent, whereas somebody that's highly compensated may not.

It's going to differ based on your age of entry, and there are certain professions in public service in California that people don't start until they're, say, mid-30's. And I think the average starting age for state employment for a number of employees is around there. So you're not going to earn the same service, depending on when you're starting the age.

So the difficulty is having one shoe fits all. I personally have no opposition to the formulas you suggest, but I would see them being in addition to as opposed to replacing any formula that's currently on the books.

I know Mr. Seeling would hate to administer any more formulas simply because it's just more difficult. The more you have, the harder it is.

But to say that one is better or more adequate than another is just difficult to prove when you look at it on a case-by-case basis.

CHAIR PARSKY: Dave?

MR. LOW: I have a few questions.

First of all, one of your points is that you should give employers greater flexibility in determining when a part-time employee is entitled to pension benefits.

My understanding is the threshold today is 20 hours a week, four hours a day. And a four-hour employee has to work two years to get one year of service credit.

So maybe you can give me your rationale as to why that's not an adequate threshold and what you would recommend.

MR. STENBAKKEN: Well, I think this gets into what Curt had mentioned earlier, and that is I think what we were after there was trying to recognize that we do have part of our workforce that is part-time, part-time permanent, temporary part-time. And we also have people who are in positions that traditionally don't become career employees.

And what we were looking for is some kind of flexibility in the system to recognize employees in those kinds of situations.

MR. LOW: Isn't it true, though, that a part-time employee who doesn't work five years, doesn't vest, they leave the system, they take their contributions out, you keep the contributions that you've contributed in the system?

MR. STENBAKKEN: Yes, that's correct.

MR. LOW: And so the only part-time employees you'd be paying pensions to would be employees that vest five years, which would mean they've worked ten years, which sort of defines a career employee to me, after about ten years.

MR. STENBAKKEN: I think there are all kinds of different ways to approach it. What we were, again, looking for is just some flexibility to deal with what we saw was kind of a rigid definition of a part-time employee.

MR. LOW: My second question relates further to this formula issue. I don't share Mr. Pringle's admiration for your schizophrenia on this. You know, you say you oppose two-tier, and then you're proposing two-tier, and then you represent cities all over California.

What about considerations for local control, geographic differences, cost of living, and all the other issues that Mr. Walton and others have raised here? How do you justify that position?

MR. STENBAKKEN: Well, we're dealing with that situation now. I mean, we have retirement systems and different kinds of retirement systems, the State Teachers' Retirement System. If you retire in Crescent

City or Los Angeles, it's the same. I mean, that's kind of a constant issue with any kind of a retirement system.

What you try to do is target something that's reasonable, that rewards your career employees, tries to maintain their standard of living in retirement, and you set your formulas.

We also have some flexibility -- we have flexibility locally to set different standards, too.

MR. LOW: Yes, and I guess my concern is, you have local elected officials who bargained for certain retirement benefits. And I have trouble with the concept of them reaching agreement locally for retirement benefits or formulas and then sort of asking the Legislature to save them from themselves.

MR. STENBAKKEN: Well, you know, I'm -- this is Dwight Stenbakken speaking, and not the position of the League of California Cities Board of Directors.

MR. PRINGLE: Or any individual city?

MR. STENBAKKEN: Or any individual city thereof or any mayor of any city thereof.

CHAIR PARSKY: South of Fresno.

MR. STENBAKKEN: You know, we -- quite honestly, there are a lot of sins that get covered over in these kinds of decisions locally.

My own personal opinion is that we could have been harder at the collective bargaining table and should have been harder at the collective bargaining table than we have been, and that's why we're in the trouble we're in.

MR. LOW: Or you could look at it from you were fair at the bargaining table, and -- we won't get into that today.

My third question --

MR. KEIL: Dave, can I add just a couple of comments to that?

The first is, there's no question that, with one exception that I could think of in the last 20 years, the benefit changes that have been offered to us by the Legislature have been higher benefit levels, to which often is essentially handing us enough rope to hang ourselves with in terms of benefit increases.

But particularly, on the miscellaneous side, I agree with you and I agree with Dwight's comments, that we have not been tough enough at the bargaining table, but that is not necessarily true of the safety benefits.

For a public-safety employee, particularly a police officer employee, it takes us a full year to train that person from POST training, to put them through on–the-field training. And generally, three-quarters -- Bob could probably confirm this -- I think three-quarters or 80 percent of them retire. That's a very big part of what they perceive to be their compensation package. And when those 3 percent formulas were rolled out, the public agencies that did not implement those 3 percent formulas were potentially becoming training grounds, investing a huge amount of taxpayer dollars in training those public safety officers who would then be recruited elsewhere where they would offer those higher benefits.

And you recall that was done at the same time we were looking at the prospective of binding interest arbitration for police and fire on a single-issue matter, later found unconstitutional, when a great many of the public agencies felt they'd better negotiate this thing, get what they can, while they can, before it's jammed upon them by arbitration.

There were pressures on the public safety side that were outside of simply discretionary control by public agencies.

MR. LOW: My third question: You mentioned --

CHAIR PARSKY: This is your fourth. That's okay, though.

MR. LOW: That was a follow-up question.

With regard to -- you made a statement that one of the reasons you feel like you need to change the formulas is this fear of public backlash; and that, you know, if you don't do this, then you're going to get it imposed on you through some initiative.

And I've been involved in quite a bit of research on this issue, a lot of public opinion research. And we're not finding the same thing in the public opinion research we have done, that there is some sentiment to that point but it's not overwhelming, it's relatively small, about 20 percent of the voters. Most of the people that we have polled feel that the structure is fair, that the overall compensation is not a problem, and that they don't see this as an overriding problem that they feel needs to be adjusted by an initiative.

So we've done four rounds of focus groups and polling on this, and all of our evidentiary refutes that.

So do you have some empirical evidence to back your point up, or is this just something you sort of feel or heard or that your people are telling you?

MR. STENBAKKEN: No, we have not done the research that you have done on this issue. I would love to see it sometime, if you want to share it with me.

But I think what we're looking at is, I think what we're looking at are a number of -- when you see what's happening in the private sector, where people are losing defined benefit plans, moving to something else or nothing, and they're being asked sometimes, in some states, to pay higher taxes for public services, that includes higher retirement benefits, there's just something about that, that tells me that the right person, with the right twist on this thing, who has got the money to put it on the ballot, could be something that we should be concerned about.

And we are. And our task force that went through this, they were concerned about that.

CHAIR PARSKY: John?

MR. COGAN: Thank you, both, for testifying. And thanks for the list of tax recommendations. I think they're going to be very, very helpful to us --

CHAIR PARSKY: I agree.

MR. COGAN: -- as we go through our work.

I have one question, it relates to the recommendations on page 4 establishing a reserve to fund future liabilities.

You mentioned that --

MR. STENBAKKEN: Where is that? Is that on the League?

MR. COGAN: Yes, on the League. Page 4, the top of the page.

MR. STENBAKKEN: The top of the page?

MR. COGAN: Establish a reserve fund for public pension systems that will help smooth the volatility of pension benefits.

I'm thinking in the context of health care as well, actually, as we've talked about this.

But the question is, how to best protect any reserve funds that might be established from, I would guess I would call it the normal behavior of legislative bodies and town councils and the like.

Did your groups give any thought to what the mechanisms might be?

MR. STENBAKKEN: They didn't talk about what those specific protection measures would be, but they did talk about the issue that you did raise: That that tends -- that that has happened before, is that when there is a reserve fund that begins to grow, then somebody says, "Well, let's use it for something else." And so they were very much aware of that. I would think for any kind of a system that would be created, that would be something that would be very much of a concern to them.

The other thing is that we also wanted it to be something that is voluntary for a local agency to do and to choose to do.

And we've gotten a couple -- I know we've gotten one, at least, and we've got some others that are looking at it, and I think this GASB thing has kind of made folks look at those kinds of options.

MR. COGAN: Uh-huh. And then on the related question of stability of employer contribution rates, you recommend that sound actuarial methods be adopted.

Did your people give some thought to what those methods might be?

MR. STENBAKKEN: Well, we had those discussions with PERS when -- and, by the way, for most cities, PERS is the retirement system, with the exception of some of our larger cities that have charter systems.

We went through those discussions with PERS. We agreed with those actuarial measures that they were taking. We think those are good to have in place, and we support those.

MR. COGAN: Right. And so if we had a health-benefits fund, you would recommend something similar?

MR. STENBAKKEN: Possibly. We didn't -- we were dealing with it in the context of a retirement issue. But, yes, that's something that --

MR. COGAN: But if you do have some thoughts, either of your organizations have some thoughts on whether those best practices or accounting practices that apply to pensions would also apply to a health-benefit fund, it would be very, very helpful.

MR. KEIL: I have nothing in the way of research that would be helpful to you, other than we have been advocating for these last long years, actually close to two legislative sessions, that we have at least options locally, should we set up trust funds to be able to place them in our retirement systems commingled with the investments of the retirement system, which presumes they be under the same actuarial standards of the retirement systems.

The one place where this has gone to the point of actually being a little bit more sophisticated is in the 1937 Act systems, which for this last year have had the authority to invest voluntarily between the requirement board and the counties any trust funds.

The statutory language is rather unstructured, which provides the option for the employer and the retirement system to be able to negotiate terms. For example, the retirement system has to protect its assets, should the employer pull out those trust funds, such as should we have the option to pay off the early debt service, for example. We cannot expect the retirement system to provide us the same interest rates it has in some of the long-term investments. It would have to be some kind of a factoring out of that.

This is the kind of thing that obviously there has to be some flexibility built in if we do commingle the funds. But we have encouraged that simply because we know we're going to get a lot better, number one, yield on return and, number two, lower overhead administrative costs.

MR. COGAN: Right, right. Good point. Thank you.

CHAIR PARSKY: Yes?

MR. COTTINGHAM: On the formulas that you offered, I mean, is there any formula that you've offered that's not available now? 2 percent at 55, 3 percent at 55, three-year averaging?

MR. STENBAKKEN: No.

MR. COTTINGHAM: So they're offered now, so this is something you could bring forward?

MR. STENBAKKEN: Yes.

I feel like a congressional hearing. We've got the godfather here.

MR. COTTINGHAM: Then I guess by asking us either to bring it forward or legislatively bring it in, that these are the only formulas available, and you're kind of asking for a non-competition clause that one city can't be offering or one county be offering better benefits, retirement benefits, than another city or county?

MR. STENBAKKEN: Yes, that's the logical conclusion of our recommendations. Very non-local control.

CHAIR PARSKY: You're swimming against the tide of this Commission.

MR. STENBAKKEN: Yes, we understand that, sir.

CHAIR PARSKY: However, that's perfectly okay.

MR. STENBAKKEN: That's why we thank you for your time today.

CHAIR PARSKY: We're happy to hear comments from all sources.

Thank you all very much.

That concludes our session.

And our next meeting will be on November 2 in Oakland.

Thank you.

(Proceedings concluded at 2:49 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 17th day of October 2007.

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