Common Sense and Post-Employment Benefits

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The Big Two:
Pensions and Retiree Medical

Orange County Employees Association

Pensions . . .

Pensions: Back to Basics

Why we need pensions

- Provide retirement security
- Provide it economically
- Provide investment capital
- Support economic growth
- Reduce need for government assistance
- Incentive for experienced workers

Pensions . . .

Pensions: Back to Basics

Differences between public sector and private sector

- Private sector: shifting to defined contribution
- Public sector: defined-benefit plans still dominate

Why?

In part, because public employers must attract and retain large, diverse workforce. (Source: Anderson and Brainard)

Pensions . . .

Pensions: Defined Benefit Plans

- Financial viability for public and employee
- Efficiency
- Pooling of risk
- The list goes on . . .

Pensions . . .

Pensions: Defined Benefit Plans

OCERS: solid long-term annual returns

1 year: 13.55%

3 years: 11.24%

5 years: 9.30%

10 years: 9.06%

14 ½ years: 9.87%

(Source: Callan data)

Pensions: Defined Benefit Plans

OCERS: lower-risk portfolio, but with excellent returns for the risk taken

OCERS has historically excelled in achieving outstanding returns for the level of investment risk.

(Source: Kuhns report regarding 84 funds)

Pensions . . .

Pensions: Defined Benefit Plans

What role does the public play?

It is commonly thought that the employer assumes most or all of the risk in a defined-benefit plan.

Not so!

Check out these figures and graphs . . .

Pensions . . .

Who really takes the risks?

These percentages for twelve years (1994 through 2005) tell the story!

Investment returns:

56.9 percent

Employee contributions and investment returns:

18.3 percent

County contributions

24.7 percent

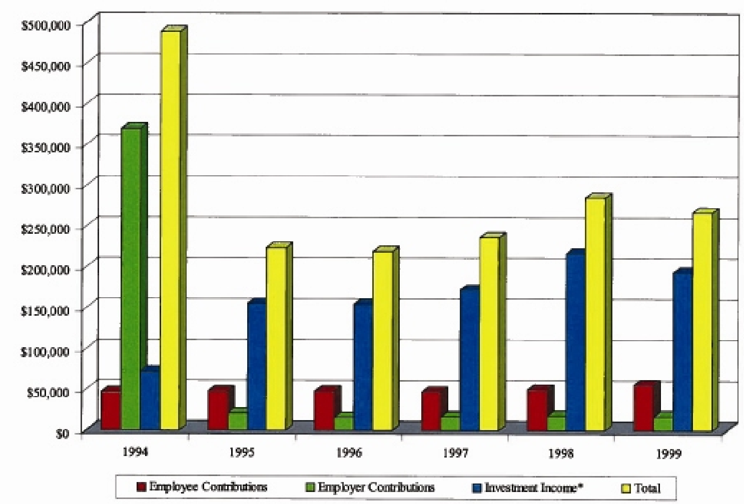
Pensions . . .

This graph covers OCERS from 1994 through 1999. The green is the County contribution. Investment returns (in blue) are by far the largest source of OCERS funding.

(Source: OCERS)

Schedule and Graph of Revenues by Source (in thousands) 1994 - 1999

	1994	1995	1996	1997	1998	1999
Employee Contributions	$47,442	$47,953	$48,461	$47,011	$50,557	$55,693
Employer Contributions	†369,382	†$20,814	†$16,463	†$17,570	†$17,977	$17,591
Investment Income*	$71,555	$154,753	$153,822	$171,623	$216,526	$193,726
Total	$118,997	$223,520	$218,746	$236,204	$285,060	$267,010



* Net of investment manager fees. Does not include net appreciation in fair market value.

† Employer contributions for 1994 include $318,300,000 of County's funding of its portion of the Unfunded Actuarial Accrued Liability. In subsequent years, agreements between OCERS and the County provided that the 1994 contribution would reduce subsequent required employer cash contributions.

Pensions . . .

This graph covers OCERS from 2000 through 2005. The red is the County's contribution. Blue represents the employee contribution. Again, investment returns (yellow) dominate.

(Source: OCERS)

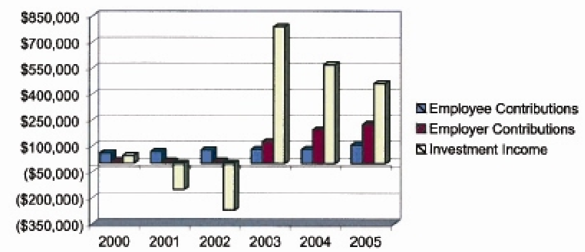
92 | STATISTICAL

Schedule and Graph of Revenues by Source

(Dollars in Thousands)

2000 – 2005

Years Ended December 31	2000	2001	2002	2003	2004	2005
Employee Contributions	$61,179	$68,635	$77,917	$81,581	$81,931	$107,544
Employer Contributions	$15,561	$12,060	$13,289	$124,243	$194,430	$226,130
Investment Income*	$45,284	($149,858)	($269,188)	$789,086	$569,000	$461,980
Total	$122,024	($69,163)	($177,982)	$994,910	$845,361	$795,654



* Includes net appreciation (depreciation) less investment manager fees and security lending fees.

Pensions . . .

<u>Financial Viability</u> of Defined Benefit Plans for Public and Employees

- Bulk of payments come from employee and especially from investment returns
- Orange County example: funding levels do vary over time (1990 and 2005)
- <u>Critical point</u>—disciplined funding plan: Orange County weathered the turmoil of early part of decade and has funding plan in place
- All three components are working – Investment, Employees, and Employer

Pensions . . .

Pooling of Risk in Defined Benefit Plans

- Retirement income is the largest financial risk for almost everyone (no one knows when they will die)
- Pooling of risk is a common, prudent way to deal with major risks (car insurance, health insurance, life insurance)
- Many forms of risk: company solvency, inflation, investment risk, others

Pensions . . .

Efficiency of Defined Benefit Plans

- Lower fees (Source: *LA Times* / per Brainerd)
- Better returns (Source: Hewitt and Callan / per Brainerd)
- Avoidance of “hidden” costs (e.g., creation of new class of elderly in dire straits)

Pensions . . .

The list goes on . . .

Defined-benefit plans benefit employer, employee, and nation alike:

- Employer contribution can be flexible according to employer needs.
- Types of investments are more flexible.
- Defined-benefit formulas are more flexible than defined-contribution.
- Defined-benefit programs are a recruitment and retention tool.
- Low-income workers less likely to need government assistance

Retiree Medical

The Orange County Plan

- Not perfect
- Not all things to all people
- Met the goals of maintaining viability in a plan that was not adequately funded (long term) when established

Retiree Medical

Key features of Orange County plan:

- Separate health insurance pool for retirees effective 1/1/08.
- “Retiree specific” health insurance options (to reduce retiree premium cost and provide benefits directed at retirees).
- County will fully fund new retiree medical program. (County’s annual contribution will be the actuarially determined to sustain the program for a period of 30 years or more.)
- Retiree medical grant maximum annual cost of living increase will be 3%.

Retiree Medical

Key features (continued):

- Retiree medical grant is reduced for retirement before age 60, and increased for retirement after age 60.
- In general, the retiree medical grant of all other current and future retirees will be reduced by 50% when and if the retiree becomes Medicare eligible.
- A separate trust vehicle will be used solely to receive the County's retiree medical program contributions, invest those contributions, administer the program, and make grant distributions.

Orange County

Role of the 1994 bankruptcy

Creation of unnecessary fears

Myth: County wobbling

Reality: County solid financially

Orange County

Orange County finances are healthy:

- Standard & Poor's credit upgrade
- Only one California County has higher credit rating
- Supervisor Chris Norby: "state of the County is strong"
- Refinancing of bankruptcy debt (2006)
- County budget allows more positions and higher salaries

In the end, it’s just plain common sense!

For Orange County, the defined-benefit pension plan is working, and it will keep working!