July 31, 2007

Public Employee Post-Employment
Benefits Commission
980 9th Street, Suite 1760
Sacramento, CA 95814

Dear Chairman Parsky and Members of the Commission;

During a public hearing held by your Commission at the University of California at San Diego, on July 27, 2007, I provided testimony, which referenced recent changes to San Diego County retiree health benefits, and the unfortunate results. You will recall that I am a member of the San Diego County Board of Retirement, of long standing.

Unfortunately, retirement issues are complicated and often don't lend themselves to an oral presentation. Following my comments, several members of the Commission raised questions which may not have been adequately addressed in the limited time available. I am, therefore, providing this short written description of the issues I addressed.

First, a bit of background; the San Diego County retirement system is operated by the legally independent San Diego County Employees Retirement Association (SDCERA), which in turn, is headed by the San Diego County Board of Retirement. The Board of Retirement is made up of four appointees of the Board of Supervisors, three elected representatives of county employees, one elected representative of the retirees, and the County Treasurer, nine in all. Pension benefits are funded by earnings of the retirement fund, annual contributions from the County Board of Supervisors and payroll deductions of active employees.

For the last 7 years, health insurance coverage for retiree's has been funded through a cooperative arrangement between the County and SDCERA, wherein the County placed required funds in an Internal Revenue Service 401h account, and SDCERA reimbursed the County by reducing the amount the County paid for normal pension benefits by the same amount they paid into the 401h account. SDCERA then made up the shortage in the pension payment from retirement fund earnings beyond the assumed and budgeted earnings level.

This circuitous process was necessary because of limiting language in IRS rule 401h and the California 1937 Act. As a result of the process, retiree health benefits were not funded by the taxpayer, but from excess fund earnings, which flowed from retiree contributions paid when they were Active Employees. Added to the contributions, were excellent investment policies over the thirty-four years, allowing the health benefits to be paid for by the Retirement Board. In addition, because they were funded through the 401h account, they were a tax-free benefit for retirees.

There are three tiers of retired employees in San Diego County, labeled Tier I, Tier II and Tier A. Six months ago the County announced it's intention to cease participating in funding Tier A retirees' health benefits, which includes essentially all retirees since 2002, plus nearly all future retirees, and refused to discuss the issue further with SDCERA. Tier A's <u>generally</u> enjoy a higher-level of pension.

The County briefly explained their action by predicting a vastly increased paper deficit that would result from new General Accounting Standards Board (GASB) rules if they continued to participate in the 401h account funding, and legal uncertainties related to ongoing litigation as the reason not to engage in discussions. They also claimed such stoppage would save taxpayer funds.

Retirees felt the County was motivated by more than a casual interest in access to increasing excess earnings, and noted that the Board of Supervisors only agreed with a compromise proposal when the Board of Retirement approved a policy that all excess earnings would go to offset the county's debt to the retirement fund until the deficit was reduced below 90%, and a portion would go for that purpose until the fund reached a 115% funded level! Retiree's also pointed out that no taxpayer's funds were being used for the health benefit program, since the funding came from earnings on employee contributions.

The result of all this was a series of heavily attended, and contentious public hearings by the Board of Retirement as they sought resolution of the matter, ultimately resulting in continuation of supplemental pension benefits - not health benefits - for Tier A's. But, the supplemental pension benefit is now taxable income, because it's not funded through the 401h account. It's unclear that SDCERA is authorized to place funds into the 401h account. Tier A's will also lose a monthly $93.50 Part B reimbursement that was part of the previous health benefit.

These are not inconsequential impacts on Tier A retirees. Together, the result of moving to a taxable pension supplement plus the loss of Part B reimbursement is expected to cost elderly retirees at least 30% of their past health funding, at a time when health costs are increasing annually at double-digit rates and carriers are decreasing service levels.

The main purpose of my comments to your Commission was to assist members of the 1937 Act Counties in receiving untaxed benefits by requesting, in your final report, that the Legislature and the Governor put into the 37 Act a procedure that would designate Retirement Board Trustees to be Plan Sponsors for Health Benefits. The 37 Act does permit the use of "excess earnings; the only thing necessary is to designate the Trustees as "plan sponsors".

I know that your Commission and the Governor are working hard to provide health benefits to all California citizens. Here is an opportunity to provide these benefits to a large group of citizens at no additional cost to the state's taxpayers; a win, win situation possible with a small change in the law.

Thank you for your attention and interest. I would ask that you consider my suggestion while developing your Commission report.

Sincerely,

James W. Feeley

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