STATE OF CALIFORNIA
PUBLIC EMPLOYEE POST-EMPLOYMENT BENEFITS COMMISSION

PUBLIC MEETING

Thursday April 26, 2007
10:00 a.m.
Orange County Transportation Authority
600 South Main Street, Room 154
Orange, California

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

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APPEARANCES

PUBLIC EMPLOYEE POST-EMPLOYMENT BENEFITS COMMISSION

Commissioners Present

GERRY PARSKY, Commission Chair
Aurora Capital Group

MATTHEW BARGER
Hellman & Friedman LLC

PAUL CAPPIETTI
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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APPEARANCES

PUBLIC EMPLOYEE POST-RETIREMENT BENEFITS COMMISSION

PEBC Staff Present

ANNE SHEEHAN
Executive Director

DEBBIE PRICE

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Public Testimony

W. DARRYL ADAMS
Orange County retiree

STEPHEN C. ANDERSON
Retired

BOB BLOUGH
San Bernardino Public Employees Association

YVES CHERY
Los Angeles County Employees Retirement Association
Trustee/Los Angeles County Probation Officer

CINDA COMBS
Retired Employees Association of Orange County

DAVE ELDER
Self

ROBERT GRIFFIN
Retired Employees Association of Orange County

GAYLAN HARRIS
Retired Employee, Orange County

BILL KIRKWOOD
California Retired County Employees Association

MARK MCCURDY
Fountain Valley resident

HERMAN MARTINEZ
American Federation of State, County, and Municipal Employees/Local 2076
A P P E A R A N C E S

Public Testimony
continued

MICKY MAXWELL
Retired, Orange County

MIKE PADORE
County of Orange, retired

GREGORY PALMER
Anaheim Police Association

KEITH RICHMAN
California Foundation for Fiscal Responsibility

LINDA L. ROBINSON
Retired Employees Association of Orange County

REED ROYALTY
Orange County Taxpayers Association

SIMON S. RUSSIN
Los Angeles County Employees Retirement Association

DR. MARK H. SHAPIRO
CSU-ERFA/Private Citizen

KEENAN SHEEDY
Service Employees International Union/Local 721

DONNA SNODGRASS
Vice President
California State Employees’ Association

VICKI SODERBERG
Capistrano Unified Education Association

DOUG STORM
Retired Employees Association of Orange County

KEITH TANNLER
Orange County retiree

JEFF VANDERSLUYSVEER
Irvine Police Association

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APPEARANCES

Presentations

PAUL ANGELO
Senior Vice President and Actuary
The Segal Company

NICK BERARDINO
General Manager
Orange County Employees Association

JOHN BARTEL
President
Bartel Associates, LLC

DARI BARZEL
Senior Vice President
Moody’s Investors Services

GRANT BOYKEN
Senior Research Specialist
California Research Bureau

MICHELLE CZERKAWSKI
Project Manager
Governmental Accounting Standards Board

DENNIS DANNER
Director, Administrative Services
City of Newport Beach

ERIC HALL
Interim Deputy Superintendent
Capistrano Unified School District

JOE KERR
President
Orange County Professional Firefighters

DICK KURTH
Deputy Director, Administrative Services
City of Newport Beach

JOHN M.W. MOORLACH
Orange County Board of Education
APPEARANCES

Presentations
continued

LESLIE L. THOMPSON
Senior Consultant
Gabriel Roeder Smith & Company

PARRY YOUNG
Director
Standard and Poor’s

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BE IT REMEMBERED that on Thursday, April 26, 2007, commencing at the hour of 10:00 a.m., at the Orange County Transportation Authority, 600 South Main Street, Room 154, Orange, California, before me, DANIEL P. FELDHAUS, CSR 6949, RDR, CRR, in the state of California, the following proceedings were held:

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CHAIR PARSKY: Ladies and gentlemen, let's see if we can begin our program.

First of all, I want to apologize for not having quite enough seats for everyone. We have an overflow crowd. We have a room, I think it's Room 103, if people want to have a seat. And if there's not too many people that don't have seats, maybe we can bring in some extras without violating any fire rules.

I want to thank Curt Pringle and all of our Orange County friends for hosting our session today. As I think we indicated at our first meeting, that we plan to hold Commission meetings throughout the state, and in an attempt to both learn from experts and other interested parties as to how local communities assess the nature of the post-retirement benefits issue that we are trying to address, and at the same time, hopefully begin to educate the public as to the nature of this problem. And so we really thank all of you here in Orange County
for hosting us.

The agenda today, which has been posted, is quite full. We plan to go with a short lunch break until about 3:00 or 3:30 today, if we can get through this in an efficient way. I'll do my best to try to manage that process.

And the focus of today's meeting is, again, to try to make sure that the Commission and the public becomes more acquainted with the issues that we're facing. We have a number of subjects that we're going to address, all of which are outlined in the agenda.

I think from an administrative standpoint, we're going to have a public comment period. And we welcome commentary coming from the public.

I think we'll hold off on any Commission Members' responses or questions to the public comment. And once we get into our individual presentations, we'll let those presentations go forward, and then we'll give each Commission member an opportunity to raise questions, have a dialogue back and forth. And we'll try to keep to our schedule. I'll try to give an indication of about how much time overall that we'll have. But we'll try to give each Commission member an opportunity to ask any questions.

And, obviously, written material that anyone
would like to submit, we welcome.

   Anne, any other commentary, administratively?

MS. SHEEHAN: No, that's great. Thanks.

CHAIR PARSKY: And with that, we'll move into our Public Comment period.

   We'll try to do this, given the -- I think there are 24 speakers in all.

MS. SHEEHAN: Twenty-four speakers, yes.

CHAIR PARSKY: And we'll try to do this -- and keep your commentary to three minutes. I mean, having served with the University of California, I know that keeping this time frame is not the easiest thing in the world. And we don't want to be impolite, but we do want to get through the entire agenda.

   So our first speaker is Donna -- is it Donna Snodgrass?

Please come forward.

I'm sorry, any other comments that any Commission Members would like to make before we get started?

   (No audible response.)

CHAIR PARSKY: Fine.

Please proceed ahead.

MS. SNODGRASS: Am I at the right place?

CHAIR PARSKY: You can be right there is fine.
Good morning, Mr. Chairman and Commission Members. My name is Donna Snodgrass. I'm the vice president of the California State Employees' Association. I appreciate an opportunity to testify here today on behalf of our 140,000 members, including state and university workers and retirees.

We are pleased that the president of one of CSEA's four affiliates, Jim Hard, SEIU Local 1000, is a member of this important commission.

The key points I want to talk about today are not new to any of you, but I think they bear repeating.

First, there's no pension crisis in California. CalPERS and the majority of local pension systems are solvent and their assets are growing daily. In fact, CalPERS is now 90 percent funded, with over $230 billion in assets. And some county and municipal plans are 100 percent and more funded.

Some public pension opponents have tried to manipulate the figures from the years 2000 and 2001, the worst stock market period in the last generation, to argue that there is a pension crisis today. But even
The Wall Street Journal says that most pension plans are now healthy.

They also keep repeating the myth that public employee pension benefits are extravagant. The average state retiree covered under CalPERS receives a pension of less than $1,700 per month after 20 years or more of state service.

Trust me, no one is growing rich on a $20,000-a-year pension.

The naysayers somehow never mention the fact that up to 3 out of every 4 dollars in public pension benefits paid by CalPERS and other funds come from investment returns, not taxes. They are also quick to point to San Diego as an example of the so-called crisis. The pension problems in San Diego are not the fault of that pension system but rather the fault of apparent manipulation of that system.

If you want to hold up San Diego as a poster child of pension problems, you must also admit that there was apparent mismanagement and misuse of those funds, and that created the problems in the first place.

My second point is that there is a problem in health-care costs in California, but it is a problem for everyone, not just state workers and retirees. We need to bring health-care costs down for everyone. Merely
shifting the cost burden to state and local public
service retirees -- the people who need the health-care
benefits the most -- or eliminating those benefits all
together is not a solution. It merely creates or
exacerbates another problem that already exists.

In the meantime, CSEA supports having state and
local governments put aside money to pay for future
retiree health costs. Prefunding health care now is a
prudent and positive step that we can take.

My final point is that public employee health-
care and pension benefits vary from city to city and
county to county. They are, in fact, local issues. Each
governmental employer has its own priorities, its own
budget, and its own level of service. It would be unwise
and unfair to try to impose a statewide solution to every
governmental agency.

And finally, CSEA urges you to deal separately
with the issues of health-care costs and pensions. We
urge you to look at the facts, not listen to ideological
rhetoric and scare tactics as you develop your
recommendation for the Governor and the Legislature.

Thank you.

CHAIR PARSKY: Thank you very much.

Next, we have Herman Martinez.

Is he here? Herman Martinez?
MR. MARTINEZ: Good morning. My name is Herman Martinez. I'm the president of AFSCME Local 2076 which represents over a thousand eligibility workers or welfare caseworkers for the County of Orange Social Services Agency.

My current retirement benefits from the County of Orange is that if I retire at the age of 62 with 20 years of service, I'll receive $1,545.94 a month. But I will have to pay $703.72 a month for my medical coverage because our group does not have a retiree medical grant, like 16,000 other County of Orange employees. So to retire for me in Orange County is pretty much out of the question, just like it was for a co-worker in our group who died several weeks ago. This person had cancer. And even though she was eligible, she wouldn't retire because she couldn't afford to pay her retiree medical premiums each month. So instead of retiring and spending her last days with her loved ones, she spent them at the office.

It's for reasons like this that the collective bargaining process is so important to organized labor groups, because that's what Local 2076 intends to negotiate next year with the County of Orange to obtain the retiree medical grant for our group so that this doesn't happen to someone in our group again.
The collective bargaining process is also important because it addresses the specific needs of employees in their region. So a uniform retirement plan applied to all employees is really impractical.

I firmly believe that the State of California and the County of Orange can provide fair retirement benefits to its employees by collectively bargaining with the organized labor groups who represent them.

Thank you.

CHAIR PARSKY: Thank you very much.

Next -- I may not say this last name right --

Jeff Vandersylvester.

MR. COTTINGHAM: Vandersluysveer.

CHAIR PARSKY: Vandersluysveer. Sorry, Jeff.

If you're not here, then maybe I could make a mistake.

Okay, Jeff is not here?

Oh, here he is.

Oh, sorry. You were in the overflow room.

Sorry. We have to give people enough time to get to the podium.

MR. VANDERSLUYSVEER: Good morning. My name is Jeff Vandersluysveer. I'm president of the Irvine Police Officers Association. I'm also a director with PORAC, Peace Officers Research Association of California. I'm
president of the Orange County Lodge 5 of the Fraternal
Order of Police, secretary of the Southern California
Alliance of Law Enforcement, and director with the
California Coalition of Law Enforcement Associations.

Everyday in California our members are out
protecting and serving the members of the community.
They're running towards danger instead of away from it.

But our system provides for their families, it
provides for them, and it's something that's safe and
secure.

The current system we have is a low-cost,
well-maintained system. It's an example for other
retirement systems around the world. It provides the
ability for us to recruit and retain quality officers
to meet the needs and the challenges of tomorrow. But
it doesn't do an adequate job when people make false
allegations toward the system.

The system is not in trouble. It is not in
peril as was said before as an example. Our current
system has funds over $100 billion. So it's over
90 percent funded. 75 percent of the returns come from
investments. The rest is split between the employer and
the employee. When the employers took vacation -- or
they took vacation from making contributions and they
used their money for other things, the employees kept
making their contributions like they were supposed to.

When you have extra money, you're supposed to
save and bank it, not spend it on other things.

We took steps on top of that to provide for
security for tomorrow with retiree health care. In my
city, Irvine, we do not have a retiree health-care
system, so we implemented a VEBA, a voluntary employee
benefit association, to help provide for our future for
health care. That made us give up some salary, made us
give up some benefits in order to get that.

Furthermore, that didn't meet our needs so we
implemented our retiree health savings plan, again,
giving up some of our salary and benefits to provide for
tomorrow rather than relying on someone else to do it for
us.

We can't turn away from danger like some other
professions can. If surgery is too difficult for a
doctor, he can refer it to another doctor. If a job is
too hard for a contractor, he can refer it to a different
contractor.

We don't have that luxury. We expect every
officer, every public safety employee to be able to
handle every situation and not turn away from it.

We were promised a secure, fair, and what we
believe is a well-earned retirement; and we expect that
Thank you.

CHAIR PARSKY: Thank you very much.

Next, we have Micky Maxwell.

Is she in the overflow room, too?

MS. MAXWELL: Right here.

CHAIR PARSKY: Okay, did I pronounce your name correctly?

MS. MAXWELL: That's right, Micky.

Good morning. Good morning, thank you for allowing us to speak.

My name is Micky Maxwell, and I'm a retiree from the County of Orange, where I started working in 1973.

You may see my button that says "Retiree."

There are a number of us in the audience. But we do not represent fully the retirees. We are the ones who are healthy enough and are financially solvent enough to be able to come here. That is probably not our majority.

When I walked in, I saw a sign at the greeting desk that said, "Under Measure M, promises made, promises kept."

I think that would be a very good slogan for everybody in government and everybody who is making part of this say and part of this process.
You have heard from people who are active, who are actually representing somebody, say they are planning for their retirement.

We planned for our retirement, too. And we gave up certain benefits and certain salaries in order to plan for a certain retirement. Once you're retired, to have that pulled out from under you, you can no longer plan. You don't have those options.

So I'm speaking against having any retroactive changes for active retirees who are now retired and cannot change their plans for the future, because those have been set in concrete.

The last thing that I did want to say is that one of the things that we say in my church, is that two people who may not agree on anything, the things that those two people will agree on is what a third will contribute.

Therefore, if the County makes an agreement with a union that represents active employees, not retirees, they can agree on what we retirees should contribute to something that they call an unfunded liability.

I don't believe it's an unfunded liability. We are an unfunded obligation, and should not have that obligation met by increases in salaries and agreements.
between two parties who do not have our interests at heart.

Thank you.

CHAIR PARSKY: Next, we have Keith Tannler.

Keith may be in the overflow room.

UNIDENTIFIED MAN: He's on the way.

MR. PRINGLE: Gerry, maybe you could pronounce the next person.

CHAIR PARSKY: Next after that, we have Dr. Mark Shapiro, if he could be ready, that would be good.

But Keith Tannler is next.

And after Mark Shapiro, we have Bob Blough.

MR. TANNLER: Hello. I'm Keith Tannler. And thank you for this opportunity to speak.

I'm also a County of Orange retiree. I was employed in 1971, retired after 29 years, almost 30, counting on the benefits that were promised me in good faith.

I have a chronic medical condition. I have chronic pulmonary disease, obstructive pulmonary disease, and require ongoing medical care. So my medical benefits are crucial to my future.

Over the past four years, as an example, my cost of health insurance per month increased $150. The
health grant portion of my retirement only increased $61.

I am paying per month at this point for my insurance for myself and my wife $700 a month of my total grant. Any change in this, if the county decides to reduce their portion of the health grant, is going to affect me extremely adversely. And as the previous speaker indicated, all of those of us who are currently retired count on the county meeting the obligation it promised us.

So I just strongly want to make that point and say that I'm sure all of the county -- Orange County retirees expect the county to meet their obligations.

We served in good faith for our years of service, and we expect them to do the same to us in our retirement years.

Thank you.

CHAIR PARSKY: Thank you.

Okay, next is Mark Shapiro and then Bob Blough, and then Mike Padore.

DR. SHAPIRO: Good morning. My name is Dr. Mark H. Shapiro. I'm a retired faculty member from Cal State Fullerton with 36 years of service. One of my earliest jobs also was a wildland firefighter here in California for the U.S. Forest Service.

I agree with all of the speakers that promises
made to current retirees and to current employees have to be met. They are moral obligations of the entities that made them.

There are some problems that have to be addressed; they should be addressed for people who will be hired in the future. And those are that formulas for the retirement systems have to be actuarially sound.

One of the problems that I think has hurt a lot of cities is the reduction in the retirement age for public safety members, from 55 to 50. That's taken a lot of experience out of the system, and it's also raised costs. But to put those back up to 55 must be done in a very, very sensitive manner; but it needs to be done.

The possibilities include offering a 30-year career retirement or a 55 age retirement for the maximum percentage to reward people who stay for a long time and end their service early.

But I think anything that is done has to be done for future employees, not for present employees or for present retirees. Those are obligations that are moral and have to be met.

Thank you.

CHAIR PARSKY: Thank you.

Bob Blough, and then Mike Padore, and then Vicki Soderberg, I think.
Bob?

MR. BLOUGH: Good morning. My name is Bob Blough, and I'm here as the general manager for the San Bernardino Public Employees Association, representing nearly 17,000 non-safety public employees in 28 cities from West Covina to Needles, and also 14,000 San Bernardino County employees.

These are hard-working employees that dedicate their careers and their lives to providing important public services to Californians. These hard-working employees deserve to be able to live independently after giving years of hard work in service to the public.

The public retirement systems provide the only security for many of them. Most of these employees are not eligible for Social Security. Many of them are not even eligible for Medicare.

The creation of this commission provides an opportunity to work together to ensure fair, stable, and predictable pensions and health care for these hard-working Californians who provide vital public services. We have said to our legislators: Let this commission do its important work. It is important to do it right, not just fast.

This commission may provide a way for it for all working Americans, both for retirement security and
Everyone deserves to retire with dignity. All working families deserve the pensions they have been promised. All working families deserve affordable health care. We believe it's time to ensure that everyone has a chance to retire with safety and security.

And thank you for your hard work.

CHAIR PARSKY: Thank you very much.

Mike Padore, and then Vicki Soderberg, and then Gregory Palmer.

Okay, Mike?

MR. PADORE: Mr. Chairman and chairpersons, my name is Mike Padore. I've worked for the County of Orange for 31 years. I retired in 1998, which puts my hire date back in 1967. And when I signed on in '67, I had a contract with the county. It guaranteed me a defined benefit retirement, and it also guaranteed me paid medical upon retirement. I'm not eligible for Social Security because I opted to work for the county for that number of years, 31 years.

The bait and switch has never been an acceptable business practice. And I see where what's going on is headed toward a bait and switch. And I don't think that anyone should engage in that. And I think that's where we're going.
The County of Orange in December 1994 -- and, I know, John Moorlach -- he foresaw that that was going to happen -- but we already took our hit. They withheld 10 percent of our money, and then the bankruptcy judge, fortunately, returned the money, sans the interest we would have earned. So we've taken a hit there. And over the years, the retirement board has loaned or let's say given to the county bail-out monies in the millions of dollars. We've helped them out.

And I heard it mentioned earlier, that we have to keep increasing the benefits to make it attractive to keep people. Well, we did that with Tom Mauk, the CEO, he was going to go to L.A. County. And I'm sure that he got enticed to come back. And that's what happens with our police agencies, of which I worked for, and many agencies to try to maintain or train the best people you can.

Thank you.

CHAIR PARSKY: Thank you.

Vicki?

MS. SODERBERG: My name is Vicki Soderberg. I am an English and history teacher in the Capistrano Unified School District. I am also the president of my professional organization, the Capistrano Unified Educational Association, which is a local affiliate of
the California Teachers Association and the National Education Association.

I stand before you today representing not only the 2,400 teachers in the Capistrano Unified School District, but public school teachers across the state of California. And I do appreciate the opportunity to address this commission. And as you deliberate your recommendations to the Governor, I would urge you to keep four salient points in mind:

Number one, first, it's very important to recognize that health care in this country is in crisis; and the costs are going up for everyone. No one should be surprised if the new federal accounting standards show retiree health care going up, but retiree health care itself is not the problem. The real problem is the skyrocketing cost of health care for everyone.

Secondly, as previous speakers have told you already this morning, we should not break our promises to our hard-working public employees by eliminating or reducing their health-care benefits.

But I have to add, that eliminating or reducing health benefits for new employees, especially in the field of education for new teachers, is not the solution, either.

With reasonable advanced planning, the teachers
I represent, all of California's teachers, should be able to expect health benefits that they were promised, the health benefits they have earned.

When I say "earned," I mean this: In the 15 years that I have been bargaining salaries for my teachers in Capistrano Unified, I have seen firsthand how rising health-care costs have increasingly infringed upon my ability to negotiate substantial salary increases.

Teachers not only in Capistrano Unified but across the state of California have been forced to trade off substantial salary increases in order to have just barely adequate health-care benefits.

And thirdly, school districts across the state are finding it increasingly difficult to compete with private business for the very best and brightest of our college graduates, especially in the field of sciences.

It is the promise of secure pensions and retirement health care that allow employers like Capistrano Unified to recruit and retain the very best people. If we shortchange our newly hired teachers and we all went through some kind of two-tiered system of health-care benefits, we only short-change ourselves because we won't have teachers to replace increasingly retiring teachers that we see now in school districts in California.

And lastly, as public opinion polls clearly
demonstrate, the public at large understands and supports health care for all public employees who serve the community, whether they be local or state employees, firefighters, peace officers, or public school teachers.

Lastly, I'd just like to remind the Commission, we should remain focused on the real issue: How is it that we make health care affordable for everyone? We should be holding the executives of the drug companies, the hospitals, insurance companies accountable for the outrageous costs which harm us all.

As baby-boomers retire, more people will retire and need health care, because all of us, of course, require health care as we get older.

Eliminating or cutting health care for our retired workers when they need it the most is just plain wrong.

Thank you for your time.

CHAIR PARSKY: Thank you.

Gregory Palmer, and then Reed Royalty and Stephen Anderson.

First, Gregory.

MR. PALMER: Mr. Chairman, Members of the Commission, my name is Gregory Palmer. I'm an active police sergeant and president of the Anaheim Police Association, representing approximately 407 active and
189 retired members.

We're the front-line public safety members who respond to daily and sometimes life-threatening emergencies throughout the City of Anaheim. Several members of this organization have died in the line of duty or been severely injured doing their jobs protecting the public and our society.

This current debate about pensions should not be about public employees versus private-sector employees. It's about protecting the middle class in our society. The current benefits offered to public safety officers today are not some sort of windfall for those who put on a badge and a gun daily. They're a useful and needed recruitment and retention tool to make sure that society is protected by the very best available professional police officers. This is something that the public demands.

If this were not true, why are there approximately 12,000 unfilled jobs in law enforcement today in our state? Jurisdictions throughout California are experiencing extreme difficulty in hiring qualified peace officers.

Our employees until just recently have contributed between 9 percent and 11 and a half percent of their pay towards their own retirement. Recently,
during our last negotiations, the City of Anaheim saw fit to make these payments for our employees in lieu of pay raises. Our city is also experiencing recruitment problems in hiring qualified police officers.

When talking with our current officers, I am constantly reminded that their pensions and post-retirement benefits are two very important arenas for them staying in the law enforcement profession, because having a stable workforce is highly desirable, since it takes years to become a productive and knowledgeable officer.

In fiscal year 7/1 of '99, the City of Anaheim paid 1.93 percent to CalPERS as the agency rate for safety police members. The employee rate was 9 percent.

In 2000, 2001, and 2002, the city enjoyed a holiday. They paid zero percent. And that was during the stock market meltdown. In each one of those three years, the employee paid 9 percent.

Back in 1985-1986 the City of Anaheim's rate for police and fire was 23.44 percent. Even though that rate was high, we did not get hit by a pension tsunami, and the rates gradually fell to zero.

Currently, our funding ratio is 87.2 percent on a market-value asset basis. And because of recent good returns, our funding ratio is rising and the employers'
contribution rates continue to fall.

You don't pay your entire house mortgage up-front. It's usually amortized over 30 years. If you pay 87.2 percent of your mortgage upfront, you'd be in pretty good shape for the next 29 years.

It's the same with our pension system. The distorted claim of some public officials and newspaper editorial writers that our pension system is unsound is nothing more than political gamesmanship to further their own political goals.

It does not make sense to treat a symptom of short-term market swings as a crisis of public finance or to assert that our middle-class public employees do not deserve a dignified retirement after decades of service.

Thank you very much.

CHAIR PARSKY: Thank you.

Reed Royalty, then Stephen Anderson, then Keenan Sheedy.

MR. ROYALTY: Good morning, Mr. Chairman and Members. My name is Reed Royalty. I'm president of the Orange County Taxpayers Association.

In full disclosure, I want to let you know that I'm also a director of the Orange County Employees Retirement System. But today, I speak purely from the standpoint of the Taxpayers Association.
I have three points to make.

Number one, I believe the existing benefits are overly generous. Even our own publication here, the Orange County Public Employees Retirement Journal, says that these benefits are too rich by far because of personal greed, wishful thinking, and faulty numbers.

Do we need these benefits to attract employees? No. People stand in line and fight to get public sector jobs.

Do we need to retain employees? No. As a matter of fact, these benefits have the opposite effect. When the Orange County Board of Supervisors granted 2.7 percent at 55, over 800 people walked out the door, retiring early.

Do we need it to compensate for the lower pay? No, the Employees Benefits Research Institute says that the public employees generally are paid about $11 an hour more than their counterparts in the private sector.

My second point, these benefits are unfair to taxpayers. Public employees from my experience are absolutely as good as people in the private sector. Therefore, they deserve equal benefits. They don't deserve benefits that are two or three times better.

Pensions and Investments magazine, another one of our bibles here, says, "Why should public employees
have better benefits than the working stiffs paying the
taxes?"

My third point: There are workable solutions
for the future. You can't fix the present, but you can
fix the future. We can help ourselves at the local level
with ballot measures. For example, we might go for
higher employee contributions introducing a tier 2 or
a tier 3, or whatever is appropriate in a given
jurisdiction. And voter approval of new benefits works
very well in San Francisco for everybody's benefit. But
these local reforms need help from the state. And that
is going to be difficult to achieve because, again,
referring to another issue of the Public Retirement
Journal, the legislators become, quote, "jellyfish in a
suit when they confront union representatives."

But we need some sort of a hybrid plan that is
enacted or enabled at the state level, something like
20 percent DB, 80 percent DC, something on that order.
And the most important thing we can do, the biggest
saving would be raising the retirement age, say, from 50
to 57, for safety, and for 55 to 62 or 65 for general
employees.

Thank you very much.

CHAIR PARSKY: Thank you.

Stephen Anderson, and then Keenan Sheedy, and
then Yves Chery.

MR. ANDERSON: Here's a letter for you. It's a letter that didn't get printed. It's a letter to the Press Enterprise in Riverside.

"I have been forced to suffer through two amazing editorials by your paper in which you attempt to abuse state pension programs by creating a 'doomsday' scenario.

"Boy, do I have good news for you: There's no need for hysteria.

"CalPERS has bounded back and is over 90 percent funded. As the market continues to improve, 100 percent funding may be possible again. At the height of the investment market, CalPERS was 132 percent funded. What you're talking about occurred in 2002, and represents the stock market crash when CalPERS was 80 percent funded.

"The Wall Street Journal pointed out this January: As the stock market rebounds, so have funds. That was in January, folks. CalPERS and other state pension systems provides as much as 75 percent of the cost of pensions, leaving only 25 percent of the cost pensions to be paid by the employer and employee.

"Another important fact that you have overlooked is that, as a percent of payroll costs, the
state pays less for pensions than it did 20 years ago.

"Obviously, 2000-2002 were abnormal. However, when you take them out over a 20-year span, pension costs are more or less amounting to about 20 percent of payroll.

"Since 2003, CalPERS’ returns on its investments have been 23.3, 13.4, 11.11, and most recently, 15.7.

"CalPERS is implementing a new program to decrease the effects of economic downturns. It is also encouraging the employers to prepay anticipated health-care expenses so the investment earnings can be used to offset the rising costs of health care. These programs cannot be implemented overnight, but progress is being made.

"Why are you seeking to take reliable pensions away from senior citizens, who are one of the most vulnerable groups in our society?

"CalPERS offers a stable retirement, lobbies businesses to provide senior services at the lowest possible cost. The major contributor to state employees pensions is effective and efficient and is willing to change to make it the best pension system ever.

"Why do you want Mexico to be our idol when our system is better? Let’s control ourselves, then we don’t
drag across the border a pension system that is inferior to the one we have. California workers need a good retirement system, not just something imported from Mexico."

And why do I talk about this? This is the letter that didn't get printed. This is the information that we can't get out to the public. Instead, we have another doomsday scenario. For which president, I'm not even sure.

And the last one, we still haven't found the tons of WMD, nor as we talk here, every hour, $10 million goes into that project. $10 million, folks. That's what we ought to be focusing on.

However, let me just end with one story, the story for anybody that will remember comes from Victor Franco. And it's about a man and his parrot.

And he buys a parrot, and he brings it home and he's going to teach the parrot to talk. So he says, "Polly wants a cracker, Polly wants a cracker." He did that for several minutes. It didn't work. He expanded to the afternoons, and finally to the evenings. He did this for several weeks. And then finally he takes the parrot out to the chicken coop and he throws it in and he says, "Because you don't talk and you act more like a chicken than a parrot, you don't stay in the house with
me in the evenings any longer."

He went to sleep. He gets up in the morning. He goes out and he looks at his lot and all there is is feathers. And as he walks out to see what happened, he sees it comes from the chicken coop. He opens the door and there's a dead chicken here and a dead chicken there and a dead chicken over there. And the parrot is at the end of the chicken coop with the last chicken, saying, "Polly wants a cracker, Polly wants a cracker, Polly wants a cracker."

And I see this is what's happening in our society with not being able to have a fair public hearing or a public fair discussion on this matter.

Thank you.

CHAIR PARSKY: Thank you very much.

Next, Keenan Sheedy, and then Yves Chery, and then Simon Russin.

Yes, please, Keenan.

MR. SHEEDY: Good morning. My name is Keenan Sheedy. I'm employed in the Patient Financial Services Department at L.A. County USC Medical Center. And I stand before you today as a worker and as a working stiff and a taxpayer. We are all together on that.

I'm a member of the Service Employees International Union, Local 721, which represents over
89,000 members in Central and Southern California. And I'm the chairperson of the union's Bargaining Policy Committee, which coordinates collective bargaining for over 45,000 Los Angeles County chapter employees and special district employees.

Thank you for the opportunity to address the Commission today.

In Los Angeles County, we have a process in place to address GASB 45. And we are working together to forge an L.A. solution.

What we need now is serious work and cooperation among all the parties involved.

Local 721 has been working on retiree health issues since last year. And in 2006 we met with Los Angeles County, and the parties mutually agreed to develop recommendations to mitigate future retiree health-care costs.

Earlier this year, the actuaries from the county, from LACERA -- the L.A. County Employees Retirement Association -- and the union agreed upon assumptions to be used in LACERA's actuarial valuation to comply with the GASB 45 disclosure requirements. And since this past January, we have had a joint labor management committee that has been meeting to lay the foundation for addressing GASB 45.
Our most recent meeting was Tuesday of this week, and we'll be meeting as frequently as necessary.

Both parties are committed to productive and positive solutions and discussions. We will be exploring several different options to address the issue, but in an atmosphere free of panic and destructive rhetoric.

From the union's point of view, none of these options will involve cutting any benefits for retirees or current employees; and we are opposed to any two-tiered system which adversely impacts future employees as a couple of the previous speakers have indicated.

The health-care system is broken, but it is not the fault of our retirees, nor is it the fault of our current employees. Quality health care is a fundamental, moral, and political question.

Fanning the flames of intergenerational conflict is reckless and divisive and will serve none of us.

We can craft a solution. We can secure quality health care for our current and future retirees while protecting the critical services we provide for 10 million L.A. County residents. That is what the public expects of public servants, and we will meet that obligation.

What would not be in the public interest is for
a one-size-fits-all cookie-cutter solution in California to this particular issue.

L.A. County is unique; and together, we can and will forge an L.A. County solution. And that's what the parties working together in L.A. County intend to do.

Thank you.

CHAIR PARSKY: Thank you very much.

Yves Chery.

MR. CHERY: Good morning, Members of the Commission. I'm Yves Chery. I'm a trustee on the LACERA County retirement board association -- I'm a trustee on the County retirement board. I'm also a deputy probation officer. I've been a deputy probation officer for 17 years.

I'm currently the chair of the LACERA Operations Oversight Committee. There, we deal with administrative issues concerning LACERA. I'm here to urge you to support local control.

Since 1982, LACERA has been administering the retiree health plan for retirees of nearly 50,000 members. We have currently about 150,000 total members in LACERA.

Due to our computerized system, we have been able to provide our retirees with their checks within 30 days after they formally retire.
Due to our increased outreach program, which I have been a strong advocate of, we have been able to better educate our members by providing educational conferences, seminars to our new members, our mid-career members, our preretirement members, and as well as our retired members.

In addition, we have established a comprehensive Web site that our members can use to calculate their pensions, retrieve accurate and current information regarding their benefits, and any further information that will be of benefit to them.

As a result, LACERA has saved an enormous amount of money and people power and time.

In short, since 1938 LACERA has been working for the employees of L.A. County, the people of L.A. County, and the people of California.

As a LACERA trustee and a probation officer, I urge this board to support local control.

Thank you.

CHAIR PARSKY: Thank you.

Simon -- I recognize Simon.

MR. RUSSIN: I recognize you, too.

My name is Simon S. Russin.

I saw Chairman Parsky at the Milliken conference, and I was very disillusioned that the
speakers they had at that conference. Mr. Parsky was pretty good, but the fellow from New Jersey was horrible. He attacked everybody.

CHAIR PARSKY: We're not letting New Jersey take over California quite yet.

MR. RUSSIN: I hope not. But it was really very interesting that he wasn't indicted, I think, for fiduciary breaches. That was my opinion. I don't want to go there.

Anyway, I'm Simon Russin. I'm the old-time guy on the L.A. County Board. I've been on the Board of Retirement for 25 years and the Board of Investments for 18 years. So I've seen a lot of crises that we go through.

And this is, again, just another normal problem. In another five years, things will clear up again, hopefully.

But we have a problem. The medical costs are out of control. Our last rates were 8.25 percent for retirees. The county pays out of the General Fund $400 million towards those benefits.

If you have 25 years of service, you have full coverage of the base plan. If you're vested, after 10 years, which is important for getting some benefits, you get 4 percent back. So we have a wonderful program,
we have an excellent program, and we want to keep it. And there has to be some way of keeping this program together, because retirees really rely on it.

I don't want to see things happening in other counties where half your paycheck goes to pay for your medical costs. That's just not acceptable. That's awful.

One issue I want to bring up is that for local control, instead of state-mandated programs that you might be coming up with is that in 1994 the crisis hit Los Angeles County. We're going to be following Orange County in bankruptcy. And there will be a lot of brainstorming. And what we did at that time is that the county funded a billion dollars through pension obligation bonds to bring the county up to 100 percent funding. And the deal was if we ever made any money, the county would get three-fourths of that and LACERA would get one-quarter. Well, who would ever believe the stock markets took off like they did? And so the county got an additional almost $2 billion that they could use towards retiree contributions. So there was some solution.

So what I'm saying is if you take away local control for some of these things, we won't be able to do that.

So I'm not sure where else I can go with this
thing. I'm not sure how much time I have. But it's a real important thing.

Remember that our pensions are constitutionally protected, retiree health care isn't. And that's a big problem. And so I'm not sure where we go from there.

But you have a hard job to do. And thank you for letting me speak.

CHAIR PARSKY: Thank you very much.

Bill Kirkwood, Robert Griffith, and then Linda Robinson.

I'm sorry, I didn't alert people.

Thank you.

MR. KIRKWOOD: Commission Members, I appreciate this opportunity to address you. My name is Bill Kirkwood. I was an employee at Orange County for 30 years.

I am president of the California Retired County Employees Association. This association represents the 20 counties developed under the ‘37 Act. We currently have over 100,000 members, retirees from every department of the 20 counties.

I assumed their responsibility of president because I discovered no one speaks for retirees. The only recourse we have is through legislation, the ballot box, or the courts.
Recent events have brought on some real problems.

First, double-digit increases in health-care premiums caused immediate financial hardship to fixed-income retirees.

Then, coincidentally, unions negotiated enhanced retired benefits for active employees.

Then GASB appeared, touting unfunded liabilities. This resulted in headlines that suggested that retiree health care was a problem, and had to be reduced or eliminated.

Several counties immediately rushed to change existing health plans, separating retirees from active employees for risk pool purposes.

This maneuver reduces costs for actives, but it really increases premiums for retirees.

In addition, there are proposals to eliminate health grants that have been in place for years, grants that retirees have depended upon making life choices. These are pretty grim alternatives.

We recently concluded a biannual conferences in San Bernardino, and the Counties of Orange, Sacramento, San Diego, Contra Costa, San Bernardino, Sonoma, and Tulare all reported grave concerns due to anticipated reductions in health benefits.
I do not mean to minimize the seriousness of state and county financial problems, but it is unfair to balance budgets on the backs of all the retirees whose annual benefit is $20,000.

Ladies and gentlemen, there has to be better solutions.

Thank you.

CHAIR PARSKY: Robert Griffith, and then Linda Robinson, and Gaylan Harris.

Robert?

MR. GRIFFITH: Thank you.

I'm Robert Griffith. I'm a member of the board of the Retired Employees Association of Orange County, retired from the county after 34 years of service.

I would like to suggest that the solution to this manufactured crisis of public pensions might lie in taking a long-term view. We have been overwhelmed with various politicians and editorial writers looking at the short-term, and "The sky is falling" and Chicken Little and the rest of that.

Looking at a couple of years for pension funding, especially contributions from the employers, does not give you an accurate view of what the real funding of public pensions are any more than back in the nineties, when you remember the PERS contribution
holiday. Orange County's retirement system, the County contribution for general members was less than 1 percent during some of that time. That was not an accurate view of the real funding of public pensions, either.

It takes a long view to look at what really happens with the funding of public pensions.

In a general way -- and the numbers will vary from jurisdiction to jurisdiction a little bit -- investment returns fund something usually in excess of 70 percent of the cost of the whole pension process, and of the remaining 30 percent, half is contributed by the employer and half by the employee.

You remember during the contribution holiday and the low contribution period, private employers, even if they didn't provide a pension -- if all they provided was Social Security -- were still paying 6.2 percent of payroll for their people, when public employers were largely paying virtually nothing.

I don't remember a lot of editorial writers going, "Oh, my god, this is terrible" at that time.

If we take the longer view, I think it gives us all a little bit of opportunity to take a deep breath and think a little bit further through what the solutions are.

One of the problems that probably has to be
addressed -- maybe there are mechanisms currently in place, or maybe new legislation needs to happen -- it's a budgetary problem for a local jurisdiction who has to deal with an annual 12-month budget, to have big increases in a particular item like pension funding.

There are ways to smooth that over a longer period of time. Maybe more needs to be done, so that it doesn't have the devastating impact on one year's budget. And when things are on the other side, the employer doesn't get complacent, thinking that pensions don't cost him anything, because they clearly do cost even in those years.

The big numbers that are often quoted as to what the liability is for the taxpayers needs to be taken with a grain of salt, too. Unlike most private pensions, public pensions, the employee contributes to the paying of that, just as much as the employer does in most cases. It's an equal share, the way the formulas work.

And that's often not talked about or not acknowledged in the editorials and by the politicians who want to make tomorrow's headlines with their statements.

The last point I'd like to make is that I think this idea of looking at the long-term prefunding being able to provide as much as 70 percent of the cost of the
benefit maybe gives us at least part of the solution to the health-care problem also. I think most jurisdictions throughout the state, probably throughout the country, have funded health care for retirees on a pay-as-you-go basis. That's just plain silly. I mean, that's not the appropriate way to do it.

So prefunding, putting some money in the pot, letting it generate earnings like the pension funds do, will reduce that overall liability and keep the cost to a manageable level.

Thank you.

CHAIR PARSKY: Thank you.

Linda Robinson, and then Gaylan Harris, and Doug Storm.

MS. ROBINSON: Good morning. My name is Linda Robinson. I retired after 41 years of employment, ten in the private sector and 31 in the public sector, working for the County of Orange. I have been a taxpayer for 41 years. I'm a homeowner and I'm a voter.

Thank you for the opportunity and for your attention to provide input to the Governor via your commission.

I hope this process is real, with no preset agendas determining the outcome of this hearing.

We all want reasonable solutions to unfunded
liabilities, solutions that are well thought out and which do not have unintended or dire consequences.

The Governor's process should be all-inclusive. However, notably missing from the Orange County panel is a retiree spokesperson. This omission hardly assures a complete unbiased, no-spin picture of the county's solution to unfunded retiree medical liability. The failure to include those who are damaged the most speaks volumes.

Make no mistake, as it stands today, the Orange County solution to a 30-year, $1.4 billion unfunded medical liability will unduly penalize and harm retirees. For the record, current retirees do not constitute a 1.4 billion-dollar unfunded liability to Orange County taxpayers. For the record, the retiree pool is finite, with an average age of 69. Think about that. Over the next 30 years you will see a drastic reduction in liability as pool numbers depart this earth, perhaps prematurely, given the solution adopted by our prior board of supervisors. And Mr. Moorlach -- where did he go? -- he was not on that prior board.

Last fall, that board adopted labor agreements which provided active employees who were well-represented by their unions with significant wage increases in...
exchange for reduced retirement benefits. Those same reduced benefits were unilaterally imposed on retirees without compensation but with a whopping premium increase many cannot afford, starting just eight months from now. What kind of society and government reneges on promises to its retired senior citizens on an issue as vital as health care?

Orange County should be a wake-up call to every current and future retiree in California and in this nation, regardless of whether they work in the public or the private sector.

Social Security and Medicare are not predictable safe havens for any retiree. And retirees should be very aware of what their elected representatives are willing to set in motion at their expense.

Please do not allow open season on retirees. Retirees did not create this crisis you are attempting to address, and we should not be made a convenient scapegoat.

Any support this committee could provide in the plan you will propose to the Governor would be greatly appreciated.

Thank you.

CHAIR PARSKY: Next, Gaylan Harris, Doug Storm,
and then Keith Richard.

MR. HARRIS: Good morning. My name is Gaylan Harris. I appreciate this opportunity to speak to this commission and for your coming to Orange County and allowing us to have easy access to you.

I spent 35 years working in government, most of that for Orange County. The last 15 years of that career was as the manager of employee benefits and retiree benefits for the County of Orange. We've been working with the county for a couple of years now on their plans and what they're going to do with GASB 45. I want to report that what they have is not an example that anyone else would care to follow.

I don't know what medical inflation is going to be, and I really don't think anyone in this room knows what medical inflation is going to be over the next 30 years.

I do know however that based on the rates the county has given us, the average retiree health plan costs will go up over 90 percent. This is going to drive many retirees out of the coverage. There is no way that they can afford to continue.

To give you some examples, Orange County claims to have saved $800 million through their plan that they adopted this last September and October. The average
retirement allowance is about $24,000 a year. The impact on retirees will be devastating.

I mean, basically what has occurred is costs haven't gone away, they've just been shifted from the public employer and employees to retirees. Those are the individuals that are picking up $800 million worth of liability for the next 30 years.

Retirees are facing increases in the least-expensive catastrophic $5,000-deductible plan, from $20 per month currently, to $400 per month. If retirees have a dependent, those costs soar from $180 a month today, to $680 per month.

When Medicare costs are added, the out-of-pocket costs go up to over $800 per month. And this is the least-expensive plan.

Let's look at some of the other plans and what's going to occur. In the $600 deductible, two-person plan, the costs are going to go to over $19,000 per year. Virtually, the average retirement allowance for Orange County retirees. So they can give their entire check up just to pay the costs of their medical coverage.

For some people, there aren't a lot of choices because this is the only plan that's available to them wherever they might live. All the HMOs in Orange County
are only available in Orange County. Those are only
going up to $14,000 a year. So even that is beyond the
realm of possibility for many of the retirees.

One of the things that is not mentioned is that
the county's -- their cost -- anticipated that
100 percent of the individuals will participate in the
plan. Today, 52 percent do. That other 48 percent just
can't afford it now.

The average cost is like $4,000 a year for
coverage and people just can't do it.

If you retired 20 years ago, you're lucky to
be making a thousand dollars a month in retirement. So
there's just no way that the math works out that people
can keep coverage today.

Fortunately, many have Medicare.
Unfortunately, many don't have Medicare. And those
individuals are particularly hard hit. These individuals
are looking at the possibility that because they no
longer can get their health insurance with the County of
Orange, they're going to have to turn to Medi-Cal. And
in order to turn to Medi-Cal, they're going to have to
liquidate all their assets just to qualify.

Now, this is a heck of a situation that we put
people into. And that's what's going to happen if the
plan put in motion by the board of supervisors in
September, October comes to fruition this next January 1st.

Let's talk a little bit about the payment on this. Retirees prepaid cost of health-care insurance by paying 1 percent of their pay into a retiree medical fund. Not only that, but they actually gave up interest earnings that should have been credited to their accounts but were used by the county to support payments to the retirement system. I don't know why in the world a system that generates 10 percent returns on investment will turn around and credit retiree accounts or employee accounts 5 percent. And that's basically what happened. I think that's a theft of funds from the individuals who made the contributions. But that's been a long-standing practice, not just in Orange County but elsewhere.

Okay, I believe there are many ideas that are worth looking at that could assist in solving some of the problems. We need to look at the tax advantage approaches. I think health spending accounts, HSAs, are something that need to be looked at. But they have to be funded. You don't just throw a thousand-dollar deductible plan on the back of a retiree and not provide some assistance to them to make that possible to operate. Now, if we could save a third the cost because Uncle Sam will pay for it in the way of tax breaks, let's look at
that. This is maybe something that makes a lot of sense. You know, we need to provide transparency of information used to calculate obligations.

Right now, it goes into the black hole and then it comes out of the black hole, and retirees have little to say or understanding of what is going on.

We need to provide guidance on actuarial methods of calculating liabilities. I've seen numbers double, triple, depending on the organization that you're looking at and the actuary brought into there. And this needs to be a little bit more reasonable and realistic. And the actuaries will probably work it out in 20 years, but I think we can help them along in the process. And I think CalPERS has probably a special role to play in this area. And I think over the years they've done an outstanding job.

We need to provide access to funding to prefund retiree medical obligations. People have talked about this before. But if we can look at the difference between the S & P returning 10.4 percent from 1925 until today -- that's a very long period -- compared to the cost of issuing a 6 percent bond today, that 4 percent arbitrage could be incredibly powerful in funding a retiree medical program. And I don't think we should take anything off the table. These are valuable tools
that are available.

   Who knows what that bond market is going to be
two years, three years, four years from now. Today, it's
very beneficial.

   I have other items, and I'd be glad to share
those if you would like to hear them.

   Thank you.

CHAIR PARSKY: Thank you very much.

Doug Storm, Keith Richman, and then W. Darryl
Adams.

MR. STORM: Good morning, ladies and gentlemen.

   Thank you for being here.

   And I would like to compliment the process.
This is actually the process that should have occurred in
this county, but it didn't.

   So I'd like to talk just a little bit about the
process so that you can take that back and maybe think
about it when you write your report.

   I'm a retiree. I'm not a radical. I can be
radical, but I'm speaking as a rational retiree today.

   You never start a process without a written
plan, but we did. You want to know the consequences of
the action you're taking, but we don't.

   Six months ago, the board passed this plan --
almost six months ago.
This week we went out to an RFP to the industry to find out what insurance costs would be. That is not the way you do business. That RFP is a three-week RFP. When the county spends their money -- and I know, I was there 32 years at the Sheriff's department watching those pennies -- we did not spend their money with a three-week RFP. They would have thrown us out of the office.

That process needs to be looked at and be changed.

We need to encourage the decision-makers not to become sharks, to live in a civilized society. We don't eat our young, and hopefully we don't eat our elderly retirees that are not represented in this process.

We need to include retirees in this process. You may not believe it, but they may actually have an idea. Gaylan that just spoke has a number of ideas.

Number one, how do you calculate unfunded liability? There needs to be a formula so that everyone comes from the same point of view. Those retirees have the time to develop retirement medical. We do not have plans for retirees. We need to take that time and develop those before we jump and put that -- and make that decision.

Use Orange County as an example. Not as to how
they do this, but of how to learn from a way not to do it. In other words, have a written plan, include the retirees, honor your past commitments, work with the insurance industry to develop the plans that you need.

You're here today in Orange County. This is not the fantasy TV series that you see. This is a life and death situation for many people. We need to take that very seriously.

Another question that I would ask, after 32 years of working for the sheriff, is why can the fire authority develop a system that takes care of their retirees and they were once part of the county, and the county now is abandoning its retirees?

Thank you very much.

CHAIR PARSKY: Keith Richman.

MR. RICHMAN: Thank you, Mr. Chairman and Members. Good morning. My name is Keith Richman, and I am president of the California Foundation for Fiscal Responsibility, which is a coalition of taxpayer groups and local leaders from around the state, dedicated to addressing California's public pension and retiree health-care cost crisis.

I'd like to thank Governor Schwarzenegger and this commission for taking on this fiscal crisis. Left unchecked, the spiraling cost of retiree benefits will
crowd out the needed investments in education, health care, higher education, transportation, and public safety, our state and local governments must make to improve our quality of life, and ensure that California remains competitive in a global economy.

Indeed, we have already seen many of these impacts now, both at the state and local level. They have been well chronicled from around the state.

I'd like to focus, however, on what should be the most important aspect of this commission's work: Determining a fair retirement benefit for new career employees, new career public employees.

And let me emphasize "for new employees."

As many of the previous speakers have said -- and I agree with them -- that the retirement benefits for current employees and retirees were set by negotiations between public agency officials and their employee unions, and they cannot and should not be changed.

These various generous benefits that exist now, the highest in the nation, which you will hear from the LAO, come at an unsustainable price. The first step in resolving this fiscal crisis is placing a fiscally responsible limit on the retirement benefits offered to new public employees.
In fact, using an analytical instead of a political approach to benefits design, the California Foundation for Fiscal Responsibility started with a widely recognized target replacement income level of 75 to 80 percent, and crafted a set of benefits to deliver that income at appropriate retirement ages.

In our view, those retirement ages are 55 for police officers and firefighters, 60 for other safety employees, and Social Security retirement age for everyone else.

Using the three-legged stool approach that relies upon Social Security benefits where they are available, a guaranteed defined benefit plan, and employer programs for personal savings, the three-legged stool that's historically been used, the California Foundation for Fiscal Responsibility has found that a fair retirement package can be offered using defined benefit formulas similar to those currently used in California.

Our economic modeling shows the State's unfunded liabilities for retiree health care can be fully paid with savings from fiscally responsible pension benefits within 30 years.

The key factor is requiring public employees -- again, new public employees -- to work a full career to
receive full benefits, no longer allowing office workers, road workers, mechanics, engineers, and the like, to retire at age 55 with fully paid health-care benefits. There is no reason these public employees performing ordinary jobs should be allowed to retire at least 10 years ahead of their private-sector counterparts.

This commission must also consider measures to stop the politicians' raids on public pension funds. We've heard that from other speakers also.

The intentional underfunding of annual contributions at all levels of government must be stopped, as it relies upon illusory surpluses when stock market returns are high that must be paid back when investment returns hit the bottom of the cycle.

Governments should be making their payments every year.

We owe it to employees and taxpayers, and let me say retirees also, to keep these pension funds secure and not divert them to other purposes, a fiscally responsible principal that will become even more important once retirees health-care funds are established.

California Foundation for Fiscal Responsibility will be filing a citizen's initiative in the weeks ahead to act as a template for a new fiscally responsible
promise to all new public employees. We look forward to an opportunity to discuss the details of our plan with the Commission. We are hopeful that this commission and the Legislature will adopt a similar retirement benefit limit and trust-fund protections that would eliminate the need for our initiative.

Yet as you will hear today from others, this crisis is too important to depend upon the weak wills of politicians who refuse to stand up to the special interest groups and who have thus far sacrificed California's fiscal health for their own comfort in political futures.

California Foundation for Fiscal Responsibility is hoping for the best from this commission and the Legislature, but preparing for politics as usual from a State Legislature that I'm well aware of.

Thank you very much.

CHAIR PARSKY: Thank you.

W. Darryl Adams, and then Cinda Combs, Mark McCurdy, and our last speaker, Dave Elder.

W. Darryl Adams.

MR. ADAMS: Thank you.

Honorable Commissioners, my name is Darryl Adams, and I'm an Orange County retiree.

Many of us who dedicated our entire careers to
the County do not have Medicare benefits to fall back on. Some of us are still raising our children and in many cases, providing caregiving for elderly parents. This is often referred to as the "sandwich generation." And now we will also be the "donut hole generation." We don't qualify for Medicare and we're not indigent, which means we don't qualify for Medi-Cal or SSI. We rely solely on our earned benefit. We've worked hard all through our lives, and now we'll have little or no medical benefit when it is acknowledged that we'll need it the most.

Our benefits are being marginalized when we can no longer do anything to compensate for it.

Since its inception, the county retirees' medical benefits have been in the same pool as active employees. To make the withdrawal and subsequent increase in costs to retirees retroactive without even the participation of those affected is unconscionable.

In our personal lives, if we found ourselves in financial trouble because we made poor choices, wouldn't it be nice if we could go back to our mortgage company and renegotiate the purchase price of our home?

We, the retirees, are being abandoned for the wrong reasons, for something we did not create. The county is suffering, not through the acts of dedicated employees, but through the acts of politicians and
appointed officials. Yet I haven't seen any of them
elect to take a cut in pay or benefits.

I believe that any reduction to retirees'
benefits should be directly tied to a commensurate
reduction in the salary and benefits of all elected
employment officials.

They could be given Toyota Corollas to drive
instead of Lincoln Towns Cars and their per diem could be
coupons for McDonald's Happy Meals. Perhaps we can put
that on the same ballot that Mr. Moorlach proposes for
the employees' benefits packages and let the constituents
decide their fate as well.

Thank you.

CHAIR PARSKY: Cinda Combs.

MS. COMBS: Good morning. And thank you for
this opportunity.

I thought I would just share a few numbers with
you. I don't have the big picture. I'm just going to
give you my picture.

I'm a retired Orange County employee, 70 years
old. I went to work for the county after my husband's
death. I am receiving -- or will receive very soon, they
say -- 1,890 per month. And I will be required to
forfeit virtually all of the Social Security that I
have been receiving because of the government pension
offset. I went to the Social Security office Monday, and they're computing that.

I currently pay $1,300 rent on a 500 square-foot one-bedroom apartment.

Oh, by the way, I meant to tell you that these numbers -- I'm moving to Arizona next month. I want to think of it as an adventure, but these numbers are why.

Okay, so you subtract the $1,300 from the $1,890, you get $590. My medical insurance currently is the WellWise Plan. That's a $300 deductible.

The cost to me is partially offset currently by a grant, but I understand that that is probably going to be severely cut next year.

But my insurance -- health insurance at the present, $320 for WellWise, $46 for dental, $8 for eye coverage, Medicare, $93. That totals $467.

Now, when I deduct the $467 from the $590, that leaves me $123 per month to cover the $300 deductible co-pay -- or excuse me, the $300 deductible on the health insurance, should I need it.

The co-pay, any other insurance -- automobile, car expense, gas, utilities, food, it doesn't seem workable. So at any rate, I'm fortunate because I do have, through my husband's Social Security, I have entitlement to Medicare.
The people that don't have entitlement to Medicare, their insurance would go up to $717 a month, which you can't really subtract from $590.

Anyway, that's it.

Thank you very much.

CHAIR PARSKY: Thank you.

Mark McCurdy and then Dave Elder.

MR. McCURDY: Mr. Chairman and panel, thank you for allowing me to speak here today.

I'm a resident of Fountain Valley, a resident and concerned citizen. And I've made it my priority to be involved in the safety and quality of life in my community.

Currently, I serve on two city committees and have just finished my year as the Chamber of Commerce president in my city.

I have had the opportunity to see firsthand how rising costs -- primarily escalating health insurance costs and extensive retirement benefits -- challenges the quality of life in our community.

Recently, our city has had to lay off five employees, including our city receptionist -- we don't have one anymore -- to help pay for these costs. We are now starting to contemplate our city's long-term future if things continue, including the loss of our police
department, and possibly consider someday having the
sheriff do our policing.

   It's time that we get real about excessive
retirement benefits that are not in line with the private
sector before our communities lose vital services and
quality of life. What good is it if you gain your
benefits if you don't live in a community without
services and quality of life?

   We should be grateful that we've enjoyed the
healthy and robust real estate market the last few years.
The revenue generated has helped offset these costs. The
cycle has now reversed, and we can't expect the same kind
of revenue from our real estate. And I think we need to
get real before it's too late, and we need to take what
steps and actions we can to preserve the quality of life
in our county and in our state.

   Thank you.

   CHAIR PARSKY: Thank you.

   Our last speaker is Dave Elder.

   MR. PRINGLE: Let's applaud that, the last
speaker.

   MR. ELDER: See, it's all downhill from here.
I have something I want to pass out to
everybody. I don't expect you to read it now.

   This article talks about the unfunded
health-care liability of public employees. And at the
time this was written, I was the chairman of the
Retirement Committee in the Assembly, a post I held for
ten years.

I describe the unfunded health-care liability
as a large -- as "Jaws II." And it was $100 billion when
I wrote this or when I was interviewed.

What's interesting about this article is, it
was written on September 13, 1987. And so here we are,
20 years later looking at this problem. And it turns out
that $100 billion is probably about the right number:
The state is $40 billion, and public agencies probably
make up at least one and a half times that.

This problem caused me to establish in
legislation the Post-Retirement Health-Care Fund, which
was implemented in statute about 1989. I took a check
over to PERS for $100 to start the fund. They tore up
the check and did not start it. And by now, there would
have been about 300 bucks in there just on what I put in.
It wouldn't help that lady going to Arizona very much.

Anyway, I give this to you. This is not a new
problem. The fund was created, I think, three months ago
and first started putting money into the fund that I
created in legislation in 1989.

We talk about our teachers, when I was chair,
40 percent of the teachers in the state did not have health insurance and retirement. In '86, the Tax Reform Act required them to start paying Medicare premiums on taxes. And so a lot of those are going to be covered.

But, anyway, 526 requires the school districts -- and that statute, too -- to provide health insurance to the retirees, but they have to pay the full cost. And the full cost not of the entire group, but of the retiree group. So these premiums are astronomical.

There probably needs to be addressed, making it some percentage, 125 percent. Some of these school districts, as you may know, 500 school districts in the state of California have less than a thousand students out of a thousand districts. And so when you have retirees from that very small district, the average costs can be astronomical because of the fact of these things.

This 526 approach needs to be -- maybe you want to look at that legislation and apply it to all public agencies in the state, require them to sell it -- at least sell it to the retirees. Not that all of them can afford it.

I guess in a more cynical approach to the health-care unfunded liability is simply don't allow anybody to retire. Just keep working. Keel over at your desk, and you never have retiree health-care costs.
But we have to think in terms of -- and this is kind of a gross thing, and it's meant for humor, probably for Dr. Richman's benefit -- if you think about it, about the cost of health care, Cadillacs used to be $5,000 a year -- or for five thousand bucks, you could buy a new one. They're about $50,000 now. Chart that out and see where that takes you.

There are two bills that I passed in the late eighties, AB 373 and I think it was AB 1492 -- and I am speaking from memory, and that's going rapidly -- that set up a catastrophic health insurance plan for Californians. This was stolen directly from The Wall Street Journal, a very radical publication. It called for a $50,000 deductible, million-dollar coverage. Your other insurance covered you up to whatever the amount was. Whatever was paid by the other insurance and by yourself counted toward that 50,000. But if you had a young son or daughter trying to take out a tree with their car and they were in a coma, these costs can get extraordinary. And this million dollars coverage was for that type of occurrence.

The premium at that time was $68 a year. Those bills -- those statutes are on the books, and have never been implemented. So I might direct you a little attention there.
I'll have much more to say about these other issues that are really not related to health care. But I have spent a little toiling in this field. I did set up the fund.

I've been criticized by PERS for not providing enough details in the legislation. Hell, I couldn't explain to people what I was talking about 20 years ago, let alone get any help in drafting the legislation. So it probably needs some tinkering. But now we've got people that are focused on it, like yourselves. And I appreciate, and the people of California ought to thank you profusely for taking on this issue.

Thank you very much for your time.

I think you'll find this kind of interesting. But I just want to let you know that this is not something that just happened.

CHAIR PARSKY: Thank you. Thank you very much. And I want to thank all members of the public.

I really want to thank all members of the public for commenting. We've really allowed the public comment period to be extended, in part because the purpose -- one of the basic purposes of this session, and the sessions we're going to hold throughout the state, is to hear from the public, let the public hear exactly what kind of analyses have been presented to us, and provided
input on this important issue.

The only general comment I would like to make, and perhaps I should have introduced this session today by saying something we did at the beginning of our first session, and that was that the Governor and the legislative leaders, as they established this commission, made it very clear that, from their perspective, promised pensions and health-care benefits to existing employees would be met.

There is no attempt on the part of this commission to retroactively attempt to deal in any other way, because that was one of the bases upon which the Commission was established.

And once again, the Commission is tasked with three basic responsibilities:

One is to try to identify the amount, the full amount of the post-employment health-care and dental benefits for which the governments are liable, and which the governments have to establish a way to honor.

Second, to evaluate and compare various approaches addressing their unfunded pension and health-care obligations, whatever they may be. And we can have a debate as to whether there are unfunded obligations or not. But once again, they need to be met and honored.
And finally, to propose a plan to see how the government should finance these obligations in a fiscally responsible way.

So, again, in each part of the state that we go, we want to emphasize again what has been established as a given for this commission. And I certainly appreciate concerns that have been expressed by retirees or current employees with respect to promises that have been made.

But at least the leadership that established this commission has made it very clear that they claim to honor those obligations.

A few administrative things. There is an evaluation form in everyone's packet, and I would appreciate it if everyone would, at some point during today, fill it out, to see how we can improve these sessions. It's meant for that. We've set up a Web site, which I think everyone is familiar with, so that the public can keep up to date on everything that is going on. And working with various associations of the government entities, the Commission has begun to survey local governments during this past week to collect information and data.

Before we turn to our first panel, we also have the California Research Bureau has prepared a background
briefing that are in these packets. And I just would
like Grant Boyken to spend a few minutes just making sure
everyone understands what that report is.

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

I just want to give you a very brief outline of
the contents of the report.

The purpose of the report was really to provide
sort of a broad background of many of the issues that
you'll be considering in the coming months, and it's
divided into two sections.

The first section is an overview of public
employees in California, including the size of the public
employee workforce, how public employees are distributed
among different government employers, retirement system
membership, and a broad summary of post-employment
benefits, and how those benefits are funded.

The second section of the report addresses many
of the issues that the speakers here this morning already
addressed, key issues that have shaped recent
discussions, issues such as new accounting and reporting
standards for health and other post-employment benefits,
coupled with the rising costs of health care, the rise
and fall of public pensions funds, their system funding
ratios in the late nineties, and then the fall in the
early part of the two thousands, demographic shifts that are predicted to change the nature of retirement to increase the retirement roles and also increase average lengths of retirement time.

And also it addresses recent issues about questions about whether or not government employers should follow the private-sector lead in going into defined contribution plans.

And the report really concludes with some observations of what appear to be the most -- some of the most pressing, underlying questions in all of these debates, questions about the comprehensiveness of public employee post-employment benefits, questions about the costs, how those costs can be managed and distributed. And also issues of control, control over how benefits should be designed and administered.

And before I conclude, I just want to point out a typo. We got this back from the printer, and it's always a bad omen, the very first figure has a typo in it. If you turn to page 2, figure 1, there's a part on the pie chart, that the pie slice that's labeled "CalPERS, 6 percent." That should read, "Cal-PERS classified school numbers," and the number there should be 19 percent.

UNIDENTIFIED LADY: What percent?
MR. BOYKEN: 19 percent.

CHAIR PARSKY: Thank you. Thank you very much.

Okay, we're going to now move to the first presentation, it's a panel. The subject matter is: Addressing Unfunded Liability: The Orange County Experience. And we have six members of this panel. We're going to try to complete this discussion before lunch.

So would all members of the panel please come forward. And hopefully we can fit everyone in. If we can't, then we'll bring some extra chairs.

And I think what we'll try to do here for our Commission Members is let all members of the panel make their comments and then we'll open it up to questions and we'll try to complete this discussion by 12:30.

Has the panel decided which order? Or do we pick the order?

MS. SHEEHAN: No, it's on the schedule.

CHAIR PARSKY: The order is here? Okay.

John Moorlach, you'll begin.

MR. MOORLACH: Thank you, Chairman Parsky. I'm trying to get the screen up.

Thank you very much. It is a real honor to have been invited to speak to this commission,

Mr. Chairman and fellow Commissioners. I am very
impressed with the roster you have today. We need to be
dealing with this -- what might be addressed as a
two-headed monster -- addressing pension plans and
retiree medical. I could talk on this for eight hours,
and I can certainly see that the other speakers today
could certainly give a lot of thoughts. But I just want
to give some --

CHAIR PARSKY: A little shorter than eight hours.

MR. MOORLACH: Yes. I'll keep it to seven and-a-half. Thank you very much.

I just want to start with some recent headlines.

Just last week, Contra Costa, in the
Contra Costa Times, noted that their unfunded retiree
health-care bill is now up to $2.6 billion. This is just
one county.

To make a payment of that, we had a bankruptcy
debt in Orange County where I serve as supervisor and
formerly as treasurer, we had a billion-dollar bankruptcy
debt, and it cost us approximately $90 million a year to
pay on that debt. So they probably have somewhere around
9 percent, or $234 million to set aside just to meet that
debt.

Okay, actually, they've determined that the
shortfall that they have to pay every year is $227 million. But they're only earmarking $33 million a year. That means they're $194 million short. And they'll have what we would call an unfunded liability that they'll have to report on their GASB 45 because their ARC, their annual required contribution, should be $227 million.

Los Angeles County last week, in their budget, came out and said their retiree health-care deficit is now as high as $14 billion, which just went up some $5 billion. That was in the Daily News of last week. And you can figure if they want to start making their ARC, that's about $1.26 billion a year. But they're only setting aside currently about $200 million. It's going to go up to $400 million in the next fiscal year, and you're looking at $500 million in 2010 or 2011, which still puts them short about $860 million a year.

What was very interesting is their chief administrative officer, Mr. Janssen, said that revenues were up for the third consecutive year. This is true for Orange County. Our assessed values have gone up 10 percent per year over the last three years. Very unprecedented, but as has been the trend with the real estate market, which was referred to earlier by a prior speaker. But that is slowing down. We saw just
yesterday in the LA Times that the market had dropped in
new home building, to the lowest number in 18 years.
We're starting to see it, and it's starting to impact the
counties as we move forward.

In fact, just last week, The Sacramento Bee
reported that their county assessor has issued 50,000
letters to homeowners, saying that their property values
will be reassessed down to reflect what's happening in
the marketplace in that county, which means that their
revenues will decline perhaps 10 percent, or a reduction
of $15 million per year.

This fiscal year, Orange County was lucky to
have a good real estate return, but about 81 percent of
those revenues went into our pension plan. This is also
true for New York City. Mayor Bloomberg since 2002 has
seen 75 percent of his new property tax revenues just go
into the pension plan.

So we've been very fortunate for the recent
uptick in the real estate market.

Regrettably, Sacramento County, their revenue
increases have not been enough to cover their POB, their
pension-obligation bond, payments percentile and their
pension-plan obligation. They're actually falling
behind. So this is very bad news for the County of
Sacramento.
So that just kind of gives you a little groundwork of what we're facing. We have a fiscal issue. And as elected officials, as union representatives, we have to look at the scenario and make the best decisions we can, going forward.

I don't want to spend a lot of time on explaining to you what the defined pension plan is. I just found this prescient quote from Peter Drucker which he made in 1950. Peter was here at the Claremont, just a wonderful academic speaker and writer, a management consultant of world renown. But he just kind of gives some perspective. He said the only business that should really be offering a defined benefit pension plan is one that's going to be here for 40 years. Who can actually predict whether a company will be around for that length of time to honor all those commitments?

And that is true. Well, we're finding that there is one industry, and that is government is always here. And so now we can have a defined benefit pension plan.

So I want to say two things: One, I am not anti-defined benefit. I'm not anti-employee. I just want to give you some ideas because I want to provide some balance. We're here. I think some things are broken that need to be looked at. And I think there's
lots of blame to go around where we might be able to say, okay, that's what we did before. Let's try it a little differently moving forward.

So I'm just going to give a Letterman "Top 10" kind of ideas, and then if I have time, I'll go into our retiree medical changes here at the county.

But currently, issue one is that we have very non-transparent contract negotiations, and we're finding that we have some interesting things that come up with no public input, no opportunity for people to speak. You've had some brave souls today that were able to come and able to speak. But I think we need to focus on open and public negotiations, we need to discontinue closed-door discussions with minimal public notice of a proposed contract, before an open vote.

Last fall, San Jose did everything in closed session, released the information in the morning, and that afternoon their City Council met again and voted on the contract. We might even consider retaining independent third parties to negotiate employee bargaining unit agreements.

Issue two is approving retroactive benefits. This is an immediate unfunded liability. The argument has been, "Well, we need to offer this benefit so we can recruit." But this is not retroactive -- recruitment is
not a retroactive issue, it's a prospective issue. So we have made some major gifts of public funds immediately overnight which create these large unfunded liabilities. It's a debt that now has to be paid by the taxpayers of the municipality involved.

So I would certainly provide as a remedy that we need to treat proposed enhanced benefits as a debt subject to the same limitations that are on our books with Prop. 13 and Prop. 218 requiring a vote of the municipality's constituents.

Or you also want to think about requiring that when a municipality creates a new benefit enhancement, that it should be paid the day it becomes effective. This is what the state of Georgia does, and their unfunded liability is about zero. They're 100 percent funded. If you want a benefit, you pay for it immediately. That's a model to look at.

And requiring increased employee contributions to cover the costs of enhanced and retroactive benefits, this is being done in Orange County, and I find out this morning also, it's being done in Sonoma County.

Just one example would be the City and County of San Francisco, which is a charter county. It's had the requirement that any pension enhancement be voted on by taxpayers, on their books for quite some time. And
they are currently 104 percent funded, at least as of September of 2005. The numbers have changed a little bit.

We are showing as being 69 percent funded. I believe we're now up to 71 percent, with the most recent numbers from our actuary.

But it sort of shows you that the dot-com bust is not necessarily the only argument in the room, because San Francisco went through it and today is 100 percent funded as compared to some other entities in the state, which means that we have to look at what was the impact of these increased benefits when things were really flying high.

Number three is increasing life expectancy and decreasing retirement ages. When you have a funding period that has been shortened, that creates higher payments up-front. And now when you have life expectancies going up further, you receive a longer pay-out period. So these actuarial numbers are getting to be rather astounding. And even today's LA Times business section already talks about the possibility of ever extending lifetimes with new technology coming up. So we are creating some remarkable problems going forward. Again, you can't use the word "crisis," but you still want to say, "Well, what happens if this all
plays out?” We've got to be responsible about it.

So one of the things we need to look at is perhaps going back to increasing retirement ages. Currently in Orange County it's 55; we should look at 62 for general members. And 50 for public safety, we should consider 57, in that range for public safety members. We have seen a workforce exodus, we are seeing public safety officials at 50 say four words: Why work for free? And they are retiring when they can get 80 percent of their salary, why not, and they can certainly go somewhere else and be a chief or captain or something else, or go into a different industry.

We may need to consider cost-of-living adjustments if the plan is not fully funded. That's another thing that needs to be fully reviewed.

With this issue, we've seen just a dramatic exodus of good managers leaving the county. I lost – my department last year -- my top six people, because of their ages, they said it's time to go. And they all kind of left in the month of March because April is when the cost-of-living increase kicks in, and so I'll kind of see these spikes in the month of March.

Number four, salary spiking. We're the only state that allows for computing your retirement remuneration based on your last year of service. We're
the only state out of 50 that does that. Other states are three years.

Number five, actuarial assumptions and amortization abuses. We've certainly seen a lot of interesting issues here of how to select an interest rate assumption, how to amortize gains and losses from investments, how to amortize gains and losses from plan changes, how to amortize gains and losses from experience changes. We've certainly seen a radical change in Orange County when all of a sudden your actuaries assume you would be retiring at 65'ish, and now they're retiring at 55'ish. All of a sudden, the numbers really spike, and that's what we saw here in this county.

So I would certainly think that this commission should look at standardizing, so we can at least have a fair playing field as we compare unfunded liability between county-and-county and city-and-city, because we're all using a lot of different factors. The matrix does get rather complex.

One quote, since we're quoting The Wall Street Journal quite a bit, there was an editorial by Mr. McMahon, "Public Pension Price Tag," in The Wall Street Journal this last August, and it actually referred to using a lower, a required rate of return and invest accordingly, so we can reduce the taxpayers' collective
risk.

Issue number six is asset-allocation abuses. I don't want to shock you, but money managers are part of the problem as well. Certainly they are getting compensated, and you want to follow the money. So I'm just kind of using this as a catch-all for how funds are managed. But certainly when a money manager sees that price earnings ratios are well above the mean, they should be telling you to liquidate their money so you could capture those profits, perhaps. Certainly that should have been done before the dot-com bust. But they were all saying, "No. Stay. Stay and hold onto our small caps, because we need to be paid. We don't get paid if you're not investing monies." So lots of things could have been avoided back in the early part of this decade.

So we need incentivized money managers to do the right thing, not just hang on, hold tight, and then live with the results.

Pay to play is still available. Not in a municipal debt market. I'm not allowed to pursue bond underwriters or individuals in industry for campaign contributions, yet you can go to any money manager at CalPERS or any institution here in this state and you can still go after them for contributions for your
campaigns. This was reported on by the LA Times by Evan Halper, I had the chance to meet him. He's usually out of Sacramento, but he is in the audience today. But he reported on Steve Wesley and Phil Angelides doing this.

I can give you a lot of horror stories if you were to give me a little more time on what happens when this financial opportunity gets into the mix. So I would encourage you just -- that's a simple solution in one area that's to prohibit pay to play.

Disability retirement abuses is another eight-hour discussion. But we've certainly got to develop stronger penalties for fraud and what we now call "chief's disease." 80 percent of California Highway Patrol chiefs that retire have filed for disability. Now, that's not an immediate cost to the plan, but it does cost the taxpayers because disability benefits are 50 percent tax-free. So we all carry that burden.

We also have a lot of presumptive code provisions that allow for certainly industry segments to retire based on just a presumptive whether they had a family history of heart disease has nothing to do with it. It's just that you're in this profession, and then you can retire. So some of those things need to be looked at.

Number nine -- I'm just about done with my
Top 10 -- employer contribution holidays, which I was just glad to hear a lot of your speakers mention today. New Jersey, which Gerry -- Mr. Parsky, you joked about a little bit, but the state of New Jersey is a poster child of pension plan problems. But they had a six-year holiday. They didn't make -- the government didn't make one payment for six years into the pension plan. This is just outrageous. We had Mr. Griffith who mentioned that we were paying only 1 percent into our pension plan, which, even as a board member of the retirement system, I was saying, "God, we've got to get this up. You can't just be enjoying this big reduction," but the county did, and they spent the money elsewhere. And they didn't set funds aside for when the cycle would change, as we know these cycles do occur.

So we should certainly look at requiring some kind of escrow accounts during good times to smooth out the tougher years. We need to revert to the mean as well in managing our money. And I think union leaders are right when they point to the county and say, "What did you do with our money?" That needs to be looked at.

We need to discourage unrealistic deferral and smoothing methods and we need to start having an aggressive strategy in the good years to deal with the down cycles.
Number ten is we have sluggish taxpayer wages to support growing pension costs. Just last week, we got an announcement from the private sector that most individuals in the private sector are expecting raises of only about 3 percent this coming year. But they're watching public employees earning almost 50 percent more on average than themselves in jobs of similar descriptions. So the taxpayers are starting to figure out what the problem here is, and they would like to see some remedies.

I know we've heard two-tier plans discussed quite a bit from the podium. But it certainly has to be reviewed for future hires. We also have to consider defined contribution plans or hybrids in order to share the risk burden.

Just last year, a study came out that showed that California state workers under age 50 who worked for a period of 10 to 15 or 20 years would actually receive a higher retirement income if they switched from a DB to a DC plan.

In the public sector, we have about three major solutions that are being pursued. One was mentioned earlier, and that was to do a pension obligation bond, a POB, which is substituting one debt for another.

We can also, obviously, increase our yields on
our pension funds. Ha, ha. I mean, if you can find me
the way to do that, then just spread it around and give
us all a tip.

Or we need to increase employer contributions
into the pension plan, and then, therefore, you're
hearing that the request for tax increases. But there is
a limit to that as well.

We have not seen what Chapter 9 bankruptcy can
do to pension plans. It's unproven. Although San Diego
came awfully close in the city when one of their mayoral
candidates said that that's what he would do, the next
day after he got elected, he would file for Chapter 9 and
let a federal judge try to sort it out.

And we haven't seen freezes or terminations
which are being done in the retiree medical arena.

I could talk for a little while, too, on the
retiree medical at Orange County, so I want to be
respectful of my time. But I guess I'll jump to my
conclusion and then if we have time I can come back to
this. But we need to provide fair post-employment
benefits to our workforce, we need to protect the
financial integrity of the employer, we need to honor
the obligations we've already created, and we need to
start reducing unfunded liabilities now so that our
legacy costs are not saddled on our children and on
our grandchildren. And we need to avoid taxpayer
disconnect, as they are already in polling data
showing they definitely want some type of reforms.

Thank you, Mr. Chairman, for letting me talk
this quickly.

CHAIR PARSKY: I appreciate it. You've
provided
a lot of information. We'll get through the panel and
then come back, and there maybe some questions, and
we'll move in that direction.

Joe Kerr?

MR. KERR: Thank you, Mr. Chair. I appreciate
it very much, and thank you, Honorable Board.

I’m Joe Kerr, President of the Orange County
Professional Firefighters.

The Orange County Fire Authority protects
22 cities in Orange County, 1.3 million citizens, a
quarter of a million acres of wildland and 500 square
miles.

The Orange County firefighters are a
multifunction dual role, and they've been in such places
as 9-1-1 and made 200 rescues in Katrina.

In order to understand the position of Orange
County Firefighters with regards to public employee
benefits and associated protections, you need to kind
of understand the genesis of our organization.

Orange County Firefighters were formed in the throes and chaos of the Orange County bankruptcy of 1995. At that time we had our contract voided. We had our contract abrogated. All of our raises, all of our COLAs were gone. Ten percent of our deferred comp was stolen. We had to ask President Clinton to intervene and get some of that back and help out.

We were looking at layoffs of 100 firefighters, 200 firefighter paramedics, and there was even an attempt to dissolve the entire Orange County Fire Department at that time to save $100 million.

One of the benefits of surviving a municipal bankruptcy is the knowledge that in order to secure our employees' future, we must work to secure our employer's future. And to that end, over the last decade, we have worked to bring in over $100 million in government grants and functional revenue to our employer.

However, last year we were faced with the potential loss of a benefit that we thought was secure. Our employer informed us that the retiree health-care trust, which was funded in good faith for 13 years, was going to run out of money in about eight months. There was 234 current retirees.

As a new organization, we do not currently have
a lot of retirees. We only have a little over a thousand personnel in the entire department.

Coincidentally, at the same time, GASB 43 and 45 came into play. And the results of what we were looking at is actuarial studies showed us that if no changes were made to our funding structure, our unfunded liability at the time was going to be $66 million. If the retiree medical trust could be transferred and invested with a third-party trustee and earned at an interest rate such as Orange County employee retirement system, it would be looking at a reduced rate to $27 million. If the retiree medical trust were invested at a higher yield and contributions were increased, the unfunded liability could be eliminated entirely, is what we were told.

We also recognize the fact that the concept of unfunded liability is not a disaster. It merely identifies the true ongoing costs of the benefit.

Within the context of our politically conservative county and our 24 board of directors, from 22 of our cities, and after extensive negotiations between the fire authority and the professional firefighters, we came up with the following plan.

This plan happened to work for uses in that specific time of need. I don't propose that it would
work for any other group any other time.

We pursued enabling legislation. The Governor signed AB 2863, Karnette, which allowed us to invest our retirement health-care medical trust fund money into OCERS, doubling the rate and the return. We increased our investment return by doing that.

We also asked for and received employee contributions. We raised our contributions from 1 percent from the employee to 4 percent. We did this by basically using a pending COLA, and our members ratified that by 90 percent.

We also increased one-time cash contributions from the Firefighters Association Health-Care Trust of a million dollars, and from the Fire Authority, they put in $7 million. It was a one-time cash infusion of $8 million.

We established a new benefit plan for future employees. It's not something you want to do as a labor leader, but it's one of the few options we had left. We established a benefit plan for employees hired on or after January 1st, 2007. This new plan is a retiree health savings plan, and the employees contribute the same amount of 4 percent of their base salary.

Contributions are deposited in individual accounts, managed by the employee for the future retiree
medical expenses. We believe that this new program is going to offer the same retiree health-care coverage as what their brothers and sisters received in the previous DB plan.

The agreement was based on several actuarial analyses that showed contribution rate of 4 percent of salary, earning an assumed rate of 7.75 percent would fully fund the benefit for our active employees for over the next 30 years. Several other factors contributed to this agreement. We were committed to solving this issue without separating our retirees from active employees for the purchase of their health insurance.

We offered health-care benefits to both the retirees and our active employees. If we were to separate our retirees from this pool, the increased utilization rate was going to make health care unaffordable. And, again, we recognize this solution does not work for all agencies. The Fire Authority had only 234 retirees affected by this issue. This made the dollar amount necessary to fix the problem for us achievable.

One of the components of the issue is the one-time cash contribution. We were able to free up money to get that one-time cash contribution by savings that we realized previously.
We saved some money on workers' comp costs and utilization of employee health care by implementing a wellness/fitness program. The median age of our firefighters is 46. The median age of our entry firefighters is 34. Half of our force is eligible to retire in six years.

In addition to that, we lost 1 percent of our workforce due to line of duty deaths in an eight- or nine-year period. Eight firefighters in the thirties and forties died from detectable and preventable illnesses and injuries.

One of our 44-year-old fire captains died in a firestorm in Riverside three weeks after he buried his firefighter. So we had to do something. And what we did is we created a labor management cooperation to implement a wellness/fitness program.

Since the inception of the wellness/fitness program, which includes annual tests, the Fire Authority has only lost one firefighter to occupational illness and has stabilized workers comp costs to previous levels. In 2002 they went up 300 percent. We've gone back down to previous levels.

The utilization rate of health insurance for our firefighters has also been reduced significantly. The reduction has produced a considerable savings in the
cost of employee medical insurance. And due to those savings, realize that the implementation of the WEFIT Program, both the firefighters and the Fire Authority were able to put that one-time cash infusion into the negotiated solution to this issue. It worked for us.

In closing, I'd just like to offer some basic tenets that we'd like -- what we followed, that are precepts that we think are important on behalf of the Orange County firefighters. We recognize that one size does not fit all. What works for us may not work for anybody else. We also recognize and respect that locally negotiated contracts should be respected.

We would have preferred to have kept the DB retiree health-care plan, but it was not an option for us. We don't propose that any other entity should emulate what we've done. It was our solution to a local problem, not something that can necessarily be copied. Circumstances forced the firefighters into these negotiations. No labor organization wants to create a second class or second tier of employees, even though we inherited a two-tier retirement system from our predecessors.

The current issue is extremely complex. It requires the full cooperation of labor and management and policy makers to achieve a solution that fits the current
conditions and will stand the test of time, as far as we're concerned.

The Orange County Professional Firefighters are not proponents of establishing multiple tiers. And that's something we really need to make sure that everybody's aware of. Because we think that in the future, when the Baby Boomers are pushed out by the Gen X'ers, it may manifest itself into disgruntled and angry employees demanding that they also be made whole.

The solution to the retiree medical trust issue helped to, we believe, ensure the long-term viability of our defined benefit pension program because there was some freeing up of some money that helped substantially.

Our solution to this issue was based on a fusion that married the savings from our workers' comp, the savings of reduced health-care utilization, the advantages of a fully funded retiree health-care system, and the support of local government structure that was open to the mutual benefits derived of these programs. We had support from the Legislature and the Governor in the signing of that bill that allowed us to double our investment return, and we appreciate that very much.

The result in savings that we realized by the implementation of the WEFIT program is what made this program possible. Without it, having been in the right
place at the right time, we may not have had these options available to us.

And lastly, we believe that retirement benefits are significant enhancement to the state's economy, and that they provide a tremendous boon to our local economies.

I gave you basically a little bit more detail. All the attachments you should have in front of you, and the CD. And if you don't have it, I'll get those to you.

We've also attached a statement of facts from the California Professional Firefighters or state counsel on these issues. And I've got a couple folks here that are a lot more intelligent on this issue than me. If you have any specific detail or technical questions, I will be here. Thank you.

CHAIR PARSKY: Thank you very much.

Next, Nick Berardino.

MR. BERARDINO: Thank you.

First, on behalf of the members of our 17,000 Orange County Employees Association, we want to thank the Commission for coming to Orange County. And thank you very much for the opportunity to speak on this very important issue. And we want to, on behalf of our members, welcome you to Orange County.

The big two issues, of course, are pensions and
retiree medical. And we think we need to get back to
basics and take a look this whole pension issue. And we
know that pensions are there to provide security and to
provide it economically and DB plans also provide
investment capital, and without a whole heck of a lot of
fees in comparison to the fees of DC plans, where -- as
my favorite supervisor would say --

CHAIR PARSKY: I noticed you were groping for
the adjective. But that's okay, don't worry.

MR. MOORLACH: Thank you, Mr. Berardino.

MR. BERARDINO: You know, who are making
enormous money on those fees. And, you know, it goes to
reduce the need for government assistance in the later
years, where if you don't have a sound pension program,
you're going to pay for it in terms of other benefits.
And it does provide incentive for experienced workers.

On the differences between the public sector
and private sector, we see more the private sector
shifting to defined contribution plans, while primarily
in the public sector we have more of the still defined
benefit plans that dominate. And one reason, of course,
is we have such a large, diverse workforce in terms of
government, all kinds of jobs. You need, I think,
something that's going to attract those.

And I think one point here that we keep talking
about the private sector, the private sector -- all of us have friends in the private sector -- they say, "We have nothing. If we're going to retire, we are going to have nothing." And I mean, I even have friends at a soccer game whom my little Italian mother said, "Dominick, don't get him," because he kept pulling on me saying -- I don't mean to pull on you (referring to Moorlach), but keep pulling on him, saying, "You know, we don't have anything, we don't have anything."

And I really got upset, saying, "Well, then you should go get something. Don't say, 'Hey, look, we're dying, we're drowning,' so look, all of you come down with us." I don't know, what sense does that make?

We also think that, you know, the defined benefit plans are financially viable -- I mean, have financial viability for employees that are efficient, and they pool the risk. And I think that's very important. Because you know what? We are living longer, and that's true. But if you outlive that defined contribution plan, there comes a time in your life where you have nothing, and you will have to get public assistance. And it will be constantly in the end.

And certainly our defined benefit plan here in Orange County is very strong, very solid. And you can see by the returns, one year, 13.55 -- we'll go to the
14 and a half years and it's almost 10 percent, our assumption rate is only 7.75 percent.

And so it's over the long haul. It's not just this picture of, "Well, let's take a look at a few bad years." And we included in our comparison here some of the bad years.

And we have a very, very low risk portfolio. Among 84 funds, I think we were one of the lowest risks that exist.

What role does the public play? It's commonly thought that the employer assumes most of all of the risk in defined benefit plan. That's just not true. We took a period of time from 1994 to 2005 so we could have some really horrible years in here, and take a look at basically who's really taking on the risk. And as you can see, between the employee contribution and the investment returns, and people talking about 70 percent, that's a number that seems to escape people. You know, that risk is being taken on and paid for by the employees and investments. And there's just a couple of charts that I think are critical to that.

And one of the things that's very important to us is that we have a very disciplined funding plan in place, and it has worked. You know, all three components of this funding plan have worked. You can see by the
numbers we've flipped on the screen are working. The investment, the employees, and the employer, you know, are all working. And we think that is very critical.

One of the things about the defined benefit plan, retirement income is the largest risk, pooling that risk. And that's something we're all used to, I mean, whether it's car insurance, health insurance, life insurance, we all pool that risk.

And no one would say, "Hey, let's get rid of car insurance, health insurance, or life insurance." I mean, it just doesn't -- it doesn't make sense. The plan is very efficient, has lower fees, better returns, and avoidance of the hidden costs, which is creating that second-class citizen.

So the list goes on.

And I'll slip over the slide to quickly get to the retiree medical plan. You've heard a lot about that in Orange County. That is a very difficult thing, as you heard from our retirees. And I can tell you that definitely the plan is not perfect.

And our problem was we built that plan based on having advanced earnings, from the pension plan when those advanced earnings ran out we were down to $39 million left in the plan, and we had to do something. And it obviously didn't make everybody happy.
I have a neighbor who is a retiree who has, since that plan, walks her dog and always stops at my lawn. And I have gotten the message, and it's not helping.

The fact is that we had to -- and we thought we did -- meet the goals of maintaining viability in a plan that was not adequately funded for the long-term. And that was a tough issue. But how we did this, some of the key features of the plan, we did separate the health insurance pool for retirees effective 1/1/08. This is going to have a major impact on them. It was a very hard thing to do. But, you know, again, with $39 million left -- and, candidly, in a very conservative jurisdiction and, candidly, have a very conservative board of supervisors, you know, you have to make very hard decisions, and these were tough decisions. But separating that pool will affect our retirees and increase their costs. However, we have been told by the county and I think our board has been very diligent, saying, "We need to see a special plan for retirees that's developed." Maybe you can take well-baby checks out for most of them, and you can take some of those other kinds of things out for them that will help reduce the costs.

So the county will fund the new retiree plan.
We had an employee contribution of 1 percent, which will stop. The retiree medical grant had a cost of living part to it which was about -- it has been reduced down to 3 percent from 5 percent. A retiree medical grant is reduced for retirement before age 60. This was an incentive to get people to work until they were 60. You lose 7 and a half percent of your grant every year before 60, except for the safety members who we represent who did not have that component in their grant.

In general, the retiree medical grant for all other and future retirees will be reduced by 50 percent, when they become eligible for retiree medical care.

Now, the one thing, if you work longer than 60, you get 7 and a half percent added on to the grant. So that was something to incent people to participate. We put it in a trust, which reduced the GASB problem. And, you know, we're hopeful, it's not everything, but in our view, it was a way to save the program.

The 1994 bankruptcy was a problem for us, obviously. We think that there's no sense in creating unnecessary fears.

There is a discussion about the county wobbling. The county is in outstanding shape. In fact -- and with the DB plan and with the retiree medical plan, Standard & Poor's upgraded the County several weeks
ago to, I think, an AA- rating, so we have one of the
highest in California. Our board of supervisors chairman
said the state of the county is very strong.
We refinanced our bankruptcy debt in 2006, and the county
budget allows for more positions. So we have done
extraordinarily well. We think it just is plain common
sense that we maintain the defined benefit plan, the
pension plan is working in Orange County. There's no
need for a second tier because it's working, and we just
need to continue to let it work.

And thank you very much.

CHAIR PARSKY: Thank you.

Dennis Danner and Dick Kurth.

MR. DANNER: Good afternoon, Commissioners. My
name is Dennis Danner. I'm the administrative services
director for the City of Newport Beach. And I'd like to
present to you today what the city has done to address
the retiree medical issue in our city.

I'd like to acknowledge to my left, Dick Kurth,
who is my deputy. He was most instrumental in developing
this plan. And I'll try to be very brief.

What we'll cover today is an introduction and
overview, a description of our old program, a description
of our new program, the transition plan that we went
through, the outside support that we had and some of the
tools that we used to develop this plan.

The catalyst for the plan, of course, was the employees wanted an increased benefit due to rising medical costs. And I'll describe our old plan in just a second.

And, of course, the city wanted a new structure to limit our future unfunded liability.

So what happened? We converted our existing retiree medical defined benefit program to a defined contribution program. This was done through the meet-and-confer process, and this is very important, it's been mentioned several times today. And it was a complex issue, like trying to compare apples to oranges. The communication and explanation effort was critical.

It's favorable to the city because it permanently capped the unfunded liability. It was a more efficient use of our resources. And it was favorable to the employees because it gave them an enhanced program and offered more flexibility.

Very briefly, so you understand what we were facing, our old program provided a benefit, a defined benefit of $400 per month. The cost was shared between retirees, active employees, and the city. It was usable only for the city's medical insurance. It took seven years to vest. And most importantly, you must retire
from the city to participate.

Problems with the old program, of course, was the $400 a month maximum. There was no flexibility. You had to work seven years to retire from the city to receive any benefit.

There's no tax advantage for funds paid in. They were paid in on a post-tax basis.

And a large percentage of those who paid in along the way got nothing. It was a pay-as-you-go plan. And if you work for the city for 20 years and left the city to work for another agency, you got nothing.

The city, of course, problems the city faced was the unfunded liability. We faced pressure from our labor organizations to increase the benefit. It was understandable because of rising medical costs, but it was a big concern for the city. And it was inherently unfair that we realized that you could pay into it for a long period of time and never receive a benefit.

We first had an actuarial study done back in, we believe, 1998. And at that time our unfunded liability was about $14 million. And that was before anybody even heard of the word "OPEB."

Our new plan, it's an "integral part trust" set up under IRC section 115. It is a defined contribution plan. Each employee has an individual account. It's
their account. If they leave city service, they take that with them. The funds belong to the employee. And the city's health insurance, of course, is still available to those employees, but is not necessary that they use the city's insurance. If they have alternate insurance through a spouse or something, the money can be used to make co-pays, deductibles, or help pay the premiums of those plans.

There are three ways to get money into the new plan.

The employee, as part of the salary negotiations, and all employees agree to give up 1 percent of the projected salary increase, and that's now deposited to their retiree medical plan.

Part B, contributions, the city places $1.50 per month to each employee's account based upon years of service and age. And that initial deposit goes in after five years of employment.

And then employee group by employee group can choose to put some of their -- leave some of the proceeds into the plan.

Very important, contributions to the plan are pretaxed. And the way that that is accomplished, they're mandatory and uniform for all employees within a bargaining unit. There's no individual choice. If you
get any individual choice, even if it's a one-time irrevocable, then they're not tax favored.

Here's an example of an employee who is 32 years old and has worked for the city for eight years, the salary is $7,000 per month, 1 percent of that salary is $70. That goes into the plan. 32 years of age plus eight years of service is 40. So $1.50 times 40, is $60 goes into plan. The monthly deposit is $130.

It was very important, we had highly-paid employees that preferred that the contribution be strictly a percentage of salary. Of course, we had lower-paid employees that preferred a flat dollar amount, because health insurance costs the same for everybody, no matter how much you're paid.

And so we came up with this compromise, that it actually addressed both groups.

And I'll move very quickly here.

Investments are directed by the employees within parameters provided by the city. The city has an investment committee. It's very similar to a deferred-compensation plan, where we offer, I think, 19 different investment options. The employees -- and they're conservative -- and the employees pick which ones they want to participate in.

(Dr. Ghilarducci briefly left room.)
MR. DANNER: Withdrawals from the plan can be for any authorized medical expense as authorized by the IRS. And any earnings in the plan, any withdrawals from the plan are non-taxable at time of withdrawal.

Authorized participants to the plan -- this is important -- it's the retiree, the retiree's spouse or legal dependents. Funds remaining in the account, if any, after death of the authorized participants are reverted to the plan. This is the IRS's rule. This is not the city's rule. We thought it to be a deal-breaker when we first proposed it or when we first found out about it. But we were told by the experts that it's really not an issue. The issue is, you'll run out of money before you will die or not be a participant in the plan any longer.

That transition plan is probably the most important part of this whole story, what we struggled with the most. Existing retirees, they were not a problem. They remain on the old plan. Newer prospective employees, of course, were mandatorily rolled in the new plan. It was the current employees that we had to deal with and make it fair for all. And we struggled with this for a long, long time.

Finally, we came up with the age-plus-years-of-service concept. And as you can read on the slide,
age plus years of service totaling 49 or less you had to convert to the new program, and that's 45 for public safety employees because, of course, they retire sooner. If your age plus years of service totaled 50 or more, 46 for public safety, then you were given the option to fully convert to the new program or participate in a hybrid program with elements of both.

And the reason for that was, we have many older employees that didn't have enough time left in their careers to make that defined contribution plan meaningful, so we developed a hybrid plan. And because of the provisions of the old plan, where if you left city service -- for an example, if you had a 45-year-old employee who had ten years of service, they might choose -- and some did -- to go to the new plan, the new defined contribution plan simply because as part of the contributions to the -- you'll see on the next slide -- if you chose to stay on the old plan, then you had $100 per month contribution co-payment.

Plus, the fact that if you're 45 years old, you don't know if you're going to retire from the City of Newport Beach.

(Dr. Ghilarducci returned to the room.)

MR. DANNER: If you have aspirations to become a police chief somewhere and you may not stay with the
city, so you could choose to convert to the new plan.

The hybrid program, which I just described, is temporary, it's a one-time option for relatively older employees. They participate in the new program but retain the $400 per month provision of the old plan. They do not receive the city's $1.50 per month for age plus years of service. And as I mentioned, they must pay in $100 a month to remain on the old program. If you have 20 years left in your career, and you would think long and hard about whether you want to stay with the old program or go with the new one.

In the end, this age-plus-years-of-service we came up with was probably not necessary because people just fell out naturally with very, very few exceptions. We had about a 50-50 split of who converted to the new plan. And our average age of our workforce is over 44 years of age. And yet over half chose to convert to the new plan.

We had to get a lot of outside support to implement this. The attorney we found, her name was Shana Saichek, very knowledgeable in this field. She has worked extensively in Orange County. She is licensed to practice law in the state of Washington, the state of New York, and the State of California. And a lot of her work is done in California.
We contacted an actuary whom some of you may know, John Bartel. He's speaking later this afternoon, or scheduled to.

We tried to find somebody that would be both a trustee and a custodian as well as a claims administrator, and believe it or not, we couldn't find anybody in the entire nation that would do both.

But we did find two companies that partner with each other, ING, who is one of the largest financial companies in the world, and a company out of Minneapolis, their abbreviation is ARC, Administration Resource Corporation. And they do our claims administration.

We're, as we speak, searching for trustee custodian. We talked to Ken Marzion this morning. We understand that we may choose PERS as our fund.

This is our Cost Estimation Worksheet. And I've only got a couple of slides left. When we went through this, we went through many, many, many iterations of this program, too few to mention. And if we had to hire an actuary to go through each of the iterations, it would have been cost prohibitive and just wouldn't have been workable. So we came up with this Cost Estimation Worksheet.

And you can see a black line that goes horizontally through the center of it. That separates
many rows below. You can also see lines, vertical lines to the right, and that separates many columns.

This work sheet is actually over 1100 rows long and 75 columns wide. And what we attempted to do here was list all 1100 rows, we listed all current employees and retirees. It also captures age, length of service, likelihood of retirement, probable retirement dates, projected life expectancies, projected pay raises, projected payments into the old plan and new plan, projected cash outflows, rates of return, et cetera. And so every time we came up with a new iteration of the program, we could plug the numbers into this and get a good cost estimation of what this program was going to cost.

We did run this by our actuary, John Bartel, who did not perform an actuarial study on it, but he gave a reasonableness check and gave us his blessing.

We also developed interactive work sheets on the city's Web site so that employees could make an informed decision of which program they wanted to go into.

In this example given, this is for somebody who is converting to the new program. They were hired in 1999 -- this is just a hypothetical example -- hired in 1999 at age 23. They estimate that they can retire in
the year 2034. We estimate annual COLA increase for
salaries of 2.75 percent. And this is all interactive.
They can change the assumptions. Any of the blue boxes,
you can change the assumptions. And if you look down at
the very, very bottom right-hand corner, you'll see that
with all the assumptions that we've assumed here, that
this employee will have $1,233.87 retirement. And that
will pay for retiree medical, even monthly payments over
a 30-year period. And, again, the 30 years, there will
be zero left in this individual's account.

I realize that in the year 2035, $1,233 may not
be a lot of money, but it's better than the $400 by far.

So just in conclusion, for the employees, this
guaranteed participation, guaranteed flexibility, it gave
them tax-free money, both going in and coming out, as
well as the investments within the account.

From the city's standpoint, it permanently,
once and for all, capped our liability for retiree
medical. It will never get one dime bigger than it is
today.

Reduced risk, it is a more efficient use of
funds. But in reality, there's no free lunch. It's just
a different way to address the cost. It's essentially
prefunding our retiree medical obligation rather than
putting it on a pay-as-you-go basis and forces more of a
“pay full labor cost” as services are received, rather than after you retire.

Finally, is it adaptable elsewhere? We believe it is, at least some aspects are applicable to probably agencies' situations. But, again, I want to stress, it was done through the meet-and-confer process, it was dealt with the issue as part of the overall compensation issues. It was a problem-solving approach rather than focusing on employees as being adversaries. It was approved by a strong margin of every employee association.

And finally, the education and explanation effort was essential. Dick and I sat down with hundreds of employees and walked them through this process, and helped them make an informed decision, and it had advantages for everyone.

And that concludes my presentation.

CHAIR PARSKY: Thank you very much for that presentation.

Last, Eric Hall. And then we'll have some questions.

MR. HALL: Mr. Chairman, Members of the Commission, thank you very much for the opportunity to be here before you today.

My name is Eric Hall. I current work as the
deputy superintendent for Business and Support Services for the Capistrano Unified School District.

Prior to working for Capistrano, I was with the San Dieguito High School District down in the north part of San Diego County for 27 years, and prior to that, with San Diego Unified. I retired with 32 years of public school district experience, and currently work as a policy and fiscal advisor for many districts, including Capistrano Unified.

I think it's really great that you have invited a school district representative to be here before you, because the numbers, for example, with just Capistrano Unified are pretty daunting. For example, 55,000 students, 65 school sites, an annual operating budget of $390 million. 3,900 employees. An annual pay-as-you-go obligation for OPEB at 1.1 million. And as a result of our newest actuarial study, ongoing costs for employee retirement benefits in the $54 million range. That's simply one school district in South Orange County.

Education, as many of you know on the panel, is a very big industry. And I think it really deserves a place on this panel and really deserves some time and light of day before you. And I appreciate an opportunity to talk to with you.

I'd like to share with you just some thoughts
in three areas.

   Number one, fiscal.

   Number two, employee pension benefits for schools.

   And number three, the school district solutions and potential options that school districts face.

   I think the fiscal situation for schools are rather unique. Schools in many ways are driven by the state, driven by the state revenues; but the operational characteristics of school districts are really quite unique. Schools are strictly attendance-driven. We get about 75 percent of our revenue based on average daily attendance. So as a parent, there's no surprise when your kid isn't in the school, you get a call from the school to determine whether or not your kid has an excused absence. We put a lot of resources in counting kids, in counting attendance.

   For example, at Capistrano, enrollment there generates $5,570 per student. In San Dieguito being a high school district, we received about $6,300 per kid.

   So we do a lot of things in schools to maximize funding to the best that we can.

   As chief business officials in schools, we talk a lot about enrollment, we talk a lot about creating schools of choice, we talk a lot about trying to do open
enrollment and bringing kids back in from private schools, limiting the amount of kids that go out into charters, giving parents choices, and certainly looking at enrollment and trying to do what we can to increase attendance, because attendance is really the lifeblood of the school district organization.

We also do a lot of other things. We participate in categorical funding, we create foundations.

Mr. Chair, in the area where you live, the school that serves your area is one I work with very closely, Torrey Pines High School, that enjoys the reputation of being the number one foundation in the state of California where parents there generate about a million dollars a year for the high school of 3,200 kids. Very unique, very fortunate to have that resource.

School business offices around the state look at those kinds of foundations to supplement school funding, look at joint-use projects with my colleagues and cities and counties. We look at something called asset management. We look at lease income. And certainly today, declining enrollment as an issue facing about 50 percent of the schools in the state of California is an issue that needs to be looked at and needs to be reformed before schools are required to pay
on an ongoing basis for their pension obligations.

For example, just some quick numbers, with 30 students in an individual class generating about $5,000 per student, the quick math on that is $150,000 per classroom per year, provided all those kids are in school 182 days. And then we don't get dinged forty-plus dollars a day for each absence.

When we reduce -- when we're growing in enrollment, the growth is great. It's additional revenue. Out of that $150,000 of additional revenue we would add a teacher. We might add an instructional aide, a computer, some books, teacher's salary and benefits being in the range of about fifty to sixty-five thousand dollars in the beginning. If it's not a special ed. class, we don't have to hire an instructional aide; we have got extra money. We can do a lot of things on that float.

However, when you're declining in enrollment and you lose those 30 kids, and you lose that $150,000 per class -- and, of course, students don't leave in nice packages, a fifth grade with all 30 leaving at one time -- the staffing there does become a real challenge. But when you decline and you lose $150,000 and you lay off that teacher or reassign that teacher, you lose that sixty, sixty-five thousand dollars. You've got to take
the balance of that funding out of your operational budget. That becomes a very big challenge for school districts.

And I'm saying this as sort of an introduction to the benefit challenge because we're 85 percent people. Of the $390 million in the Capistrano budget, 85 percent of that is in employee benefits and employee salaries. So whenever we're reducing, we're talking about reducing people, reducing programs, and declining enrollment really needs to be looked at. Most educational associations have lobbied for this for the past couple of years.

And before we get into requiring through legislation for school districts to have to set aside money and long-term pension obligations, we've got to focus on that issue.

The second point on benefits. Benefits as a part of compensation packages are totally locally driven through collective bargaining. As Mr. Lipps and Mr. Hard and Mr. Low and certainly Mr. Cottingham know, collective bargaining is a local issue in school districts. So we've done a lot of things locally. And I've been involved over the many years in terms of preparation for negotiations, collecting data, actually structuring the form of contracts and the structure of benefits. We've
done a lot of things in schools to try to minimize the impact of retiree benefit coverage. Many schools have capped retiree benefit coverage at age 65. Many schools have capped the district's contribution to the premium that was applied at the time when the employee retired.

Many districts have required employees to have 15, maybe 10, 15, 20 years of service before they're eligible for these kinds of costs.

And when you look at the total dollar amount, there's no wonder why that is not an issue at the negotiating table.

But that is strictly a local issue. Very difficult for a school district to force that unilaterally. It's a give-and-take process through employee negotiations.

Now doubt that this long-term obligation is something that needs to be addressed. And I applaud you and the Governor for attempting to get your arms around it.

Those of us in the school business, who have survived the business over the years, know what the disease called "muralitis" is. "Muralitis" is a condition you have when you can't read the handwriting on the wall. Those of us in schools know what's coming down the line. We know by virtue of the fact that we're
required now to identify the obligation. And we're
sun-shining with that obligation. It's not much further
down the track to require districts to figure out a way
to fund these.

So we've been talking as a group of school
business officials around the state. We've talked about
a number of solutions. We've talked about accruing
obligations, perhaps not 100 percent of the obligation,
but accruing a portion of that obligation annually.

We've talked about funding an annual amount,
for example, a percentage of the obligation, or a dollar
amount of the obligation, depending upon the district's
ending balance.

Another option is to look at charging allowable
costs out to special programs. School districts get
special money for transportation, food services, adult
education, preschool, special ed. facilities. If we're
going to be asked to fund employee retirement,
post-employment retirement benefits from the district,
we will look at how we can fund those benefits from the
variety of funding sources we get. And guess what that
means? That means fewer people in transportation. That
means fewer people in special ed. It simply is going to
have an impact on the level of service that we'll be able
to provide.
Another thing we've looked at is setting aside a reserve in our general fund. Right now, we don't have to set aside a special reserve, although many organizations have looked at a one-way door of creating a trust. You put the money in, the accrued interest on that helps fund the obligation. Some districts are looking at setting aside a separate amount in their general fund. It gives them more flexibility, at least setting aside a reserve on a part-time part of the accrual basis.

And then the other aspect that you should be aware of that many of us who work in schools and some of us that have more than one address in school see a number of flyers, we see a number of workshops. We get called on regularly by banks and underwriters. A new trend now in the banking industry, and particularly among those school districts that are familiar with bonding for facilities, is bonding for the obligation.

I recently got a letter in Capistrano Unified from an underwriter that said, "Let us help you. Your obligation of some fifty-plus million -- guess what? -- we can keep that payment at a million dollars a year."

Of course, it's going to go up 30 years. Of course, it's going to cost us 80 million in the long run, but we're being marketed to now by banks and underwriters
in this area.

I guess in conclusion, I would just say that we realize that this obligation needs to be recognized. There's some uncertainty in what it means now that this obligation that is unfunded will show up on our annual audit. We don't know what that's going to mean on Wall Street when we go to bond or go to borrow.

It is a complex issue, particularly for schools. I've just glossed over some really large and complex issues related to school funding, related to collective bargaining.

Three numbers for you: 6.2 million, 655,000, and 1,100.

6.2 million students in the state of California, 655,000 school employees in the state of California, and 1,100 school districts in the state.

My recommendation to you would be to spend some time to bring the experts in to work through the county office, to work for the State Superintendent of Instruction, to work through a variety of other school district organizations. And I would strongly recommend that you hold a special hearing, just looking at the impact on schools, because it is unique, it is large, it is more than twice the size -- or approximately twice the size of the state program as the state has 350,000
employees, we have 360,000 teachers alone. And in
addition, another 300,000 classified or support staff.

So those are just some quick comments for you
in three areas.

Again, I really appreciate an opportunity to be
here with local government to talk a little bit about the
school impact. And I would welcome your questions and
further dialogue on the impact of this on schools.

Thank you very much.

CHAIR PARSKY: Thank you very much.

And I want to thank all of the panelists.

Now, we'll open it up to some questions.

John, do you want to start us off?

MR. COGAN: Thank you, Gerry.

And thank you all for coming and sharing your
excellent work with us.

One thing that struck me throughout this
hearing is the importance of local control. It does seem
to me that you can't separate solving this problem from
collective bargaining, you can't separate from the
particulars of the workforce that is receiving the
benefits, and from the particulars of the community.
And so the idea of local control seems to me to be a
profoundly important idea as the Commission develops its
recommendations down the road.
I agree that defined benefits plans have their attractiveness. But in the public sector, they seem to have a significant problem. The time horizon of elected officials seems to be a lot shorter than the time horizon of the workers. And so you tend to get underfunded plans, which is why we're here today, be they pension plans, be they health benefit plans.

So while I see the merits of the DB plans; I also see in the public sector this kind of systematic problem.

And so, Mr. Moorlach, when you mentioned in your presentation that San Francisco has a well-funded plan, and it requires that the voters vote for any benefit enhancement, I think is the way you put it, I was struck, until I had two questions related to that issue. One is, are the benefit levels provided to retirees in health care or in pensions lower in San Francisco, about the same in San Francisco, or above in San Francisco relative to other municipalities of similar characteristics? That is, has the solvency been achieved at the price of lower benefits for workers and retirees?

And the second question is, are there any other municipalities or special districts or whatever that require a similar vote of the public in order to enhance benefits as a way of getting around what I see as this
endemic problem that politician's time horizons are shorter than the time horizons of the workers?

MR. MOORLACH: Those are great questions, Mr. Cogan. I'm not sure I can give you precise answers on San Francisco. I have not looked at their formulas.

But I will tell you that their Deputy Sheriffs Association put a ballot measure on to improve their benefits to comparable -- to the rest of the state, and the voters approved the benefits.

So it certainly isn't an impossibility to get your benefits to where maybe other municipalities are at. So from that anecdotal fact, I'm sure their benefits are probably rather similar.

San Diego City, who just had an election in November, and made a change to their pension plan, I believe it was either Measure A or B, I apologize. But they, I think, now require a vote as well.

CHAIR PARSKY: I think that's a piece of data that would be helpful to collect and make sure that we provide that to the Commission Members.

MS. SHEEHAN: Yes.

CHAIR PARSKY: Any other questions of this group?

Yes, Dave?

MR. LOW: Just in follow-up to that comment
about local control. I heard that pretty consistently across the panel.

I'm curious about Mr. Moorlach's position on that issue. Because you recommended a number of solutions that appeared to be a mixture of local issues and statewide imposed solutions. And I notice that there is a locally negotiated resolution to this GASB issue that some people are unhappy with.

What is your position with regard to local control as opposed to statewide proposed solutions?

MR. MOORLACH: It's twofold, Mr. Low. The first is we certainly need to work with our bargaining units and our employees. It is a home issue that we need to deal with.

And I just probably want to maybe acknowledge the great job that Mr. Berardino and Mr. Kerr have done with their respective unions in the county. They certainly are suffering from the same arrows that are coming our way, as supervisors.

On the other hand, if you sat down and reviewed all the empirical data, and if you've chartered out the numbers, and if by some chance you concluded that defined benefit plans as they are currently structured with the benefits in place, if you decided those are unsustainable, and you decide, well, we'd better go with
a defined contribution plan, if we decided that independently, that would be extremely difficult to do locally. It would be very helpful to have a statewide initiative that said, "Here is what it's going to be for everyone" because the issue then would probably be recruitment. Why would I work for Orange County when I can work down the street in San Diego County or Riverside or San Bernardino, and get a DB versus a DC if they perceive the numbers don't work out?

So there is a lot of room for a statewide solution.

MR. LOW: And with regard to this question of DB/DC, the Commission just received a report recently from CalPERS, they, I guess, commissioned a study from the CSU Applied Research Center that talked about the financial footprint of this defined benefit plan. And I'm just curious about whether you looked at that issue locally. Because I noticed that it talks about $21 billion economic activity generated each year just by the pension payments and investments of the retirement systems.

Have you looked at that with regard to Orange County specifically or --

MR. MOORLACH: Thank you, Mr. Low.

I have scanned the report. I think the answer
would be the same, whether it would be DB or DC, we're still going to have funds being invested throughout the community, the country, and the world. So I think the footprint would be pretty close.

In the private sector, we now have more DC funds under management than we have DB plans. So we're already seeing a trend in that direction; and I don't think that's going to change the economic impact, whether it's one type of trust versus another.

MR. LOW: A question for Mr. Kerr.

MR. KERR: Yes?

MR. LOW: Have you experienced any sort of morale issues with regard to your new hires being in this new HSA plan?

MR. KERR: No. It's too early to tell. It's only been implemented as of January 1 of this year. But we understand that if you have three or four people on a fire engine and they're in different retirement tiers or they're in different retiree health-care tiers, eventually there could be the potential for friction, especially when those people in the DC plan become the majority and I'm their boss -- they're my boss, I'm sorry. They come to me, and they say through surveys, "We want you to make us whole." So before you can move the ball down the field, you have to really research that
and make them whole.

So we haven't experienced anything yet; but there's a potential out there for it, that's true.

MR. LOW: And I noticed that you included the California Professional Firefighters --

MR. KERR: Yes, sir.

MR. LOW: -- principles there. And so one of their principles was with regard to no two-tiers. So I guess there's some conflict between what you did there with the statewide principles there.

MR. KERR: Yes, I would say we would have preferred to stay in a defined benefit plan, all things being equal, we would have done that for all of our employees.

But we didn't have that option. When they said, "We're running out" -- our employer said, "We are running out of money. And in eight months, those retirees will not have retiree health-care coverage," we had to do something. And we did something with the available revenues we had, and that was one of the limited options available to us.

So I believe in those tenets, and I believe in those principles that we put forward, that the state counsel also mimics.

But, you know, sometimes the bankruptcy was
external influence that we had to deal with; and it seems like we're still dealing with the aftershocks of that even a decade later.

So I believe in DB plans, I believe in locally negotiated contracts, I believe in securing long-term benefits through your members, through the legal collective bargaining process. And you have to work with the available monies that you have.

MR. LOW: One last question to Mr. Hall.

You talked about the 655,000 school employees and the fact that that's twice the number of the state employees. Our research also shows that about half of the school employees, teachers and classified employees in school districts, receive no retiree health care at all. And I was just curious if you've looked into that issue and are your findings similar.

MR. HALL: Many districts require an employee to work 40 percent time, 50 percent time to receive benefits. It's strictly a local negotiated amount, depending upon the bargaining unit and the fiscal circumstances of the school district.

MR. LOW: Thank you.

CHAIR PARSKY: Bob?

MR. WALTON: Just a point of clarification.

The report from CalPERS and CalSTRS I understand only
covered the benefit payments made to retirees, it did not
cover the economic impact of investments. And that's to
come later. But I for one on the Commission would like
to see the authors of that report make a presentation at
some future Commission meeting, just so we clearly
understand the impact of that pension footprint, if you
would.

I know in Orange County there's some 10,000
CalPERS retirees living, and so I think that that
economic footprint is rather large here.

And I know CalPERS invests several hundred
million dollars in real estate, in homes, and other
companies in this area. So I think the impact of all of
that needs to be clearly understood by this commission.

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

Lee?

MR. LIPPS: Mr. Moorlach, I was intrigued by
your suggestion about completely open negotiations to
the public. This really wouldn't be the place to
discuss that.

But I'm a little bit more interested in your
statement that you believe that research shows that a
defined contribution plan is better than a defined
benefit plan. And you cite some research by the Pacific
Research Institute, which at least in my experience with
them, usually is not characterized as being non-partisan
or bipartisan. And I thought it particularly sort of a
counter to what Mr. Danner mentioned, that one of the
near deal breakers in this agreement with the employees
had to do with the fact that unused money after the
people that participated, either as the employee or the
spouse of the employee in retiree medical, but any money
that was left over would revert back to the trust, if I
understood that correctly. And you said, "Well, you
don't have to worry about that because you'll run out of
money before you die." And so I'd like you to explain a
little bit more, or at least are you aware of any other,
let's say, less partisan research that shows a defined
contribution system being better than a defined benefit
system in an average kind of system?

MR. MOORLACH: Thank you, Mr. Lipps, for the
question.

I have boxes of research. And I wasn't sure if
I should put all kinds of footnotes in my presentation.
I do apologize. I just tried to use a couple of
anecdotal supporting ideas.

I think you'll find some probably good studies
on defined contribution plans and their portability.
And you'll also find some interesting studies on
demographics on the various generations that we're using, Gen X and others that may not stay with the employer for the entire year, and would like the flexibility to move in and out of private and public and carry those benefits with them.

So I think that that is out there. And I can try and look for you, but I've already taken a lot of time today. But if you let me know, I'll go through the boxes. I am still in boxes because I changed jobs. But I can certainly try and do some Googling for you. But I think that would be data that would be well worth reviewing, especially if you want to give some options for a new employee. You can either be in this plan or do a DC. And if they have some short-term plans for their career, then it might be preferable.

CHAIR PARSKY: Curt?

MR. PRINGLE: I just want to follow up on that point. And, John, as other information is being provided to the Commission, if you, through your boxes or Googling efforts have the ability to provide any other information, we all would be glad to get and read and see what you have to share.

MR. MOORLACH: Well, maybe if I jump in, Mr. Pringle; there is a Web site -- in fact, the gentleman who manages that Web site is here today, and
that is called Pension Tsunami, and it also has a daily
clipping service. And if you're not already subscribing
or not aware of the Web site, it is an incredible
resource of just what's in the news that day around the
state, the country, and the world.

MR. PRINGLE: I just wanted to reiterate if, in
fact, this commission is always open to hear all that
stuff, because other members requested information be
distributed to all of us, that would be great if we could
have that distributed as well, if there are some specific
things that would clarify your points a little better --
or more, or add to them.

And I did have a couple questions, but I am
going to defer my questions after lunch.

CHAIR PARSKY: Teresa?

DR. GHILARDEUCCI: I hate to stand between you
and your lunch.

MR. PRINGLE: Oh, go right ahead. It's okay.

DR. GHILARDEUCCI: I have two questions. The
first one is probably for Mr. Berardino.

THE AUDIENCE: We can't hear you.

MR. PRINGLE: You have to push the button right
there.

DR. GHILARDEUCCI: Thank you.

The first one is for Mr. Berardino and probably
for Mr. Hall.

Local control makes a lot of sense, not only does it mean that the people most affected by a decision have a say in that decision, they have more information, they have more stake in it; it can be more efficient, it can be more just.

But if local control is taken to its logical extreme, it means that all of us are on our own, that it gets reduced to the individual level, and then we lose a lot of benefits we can get from solving solutions together and having larger economies of scale.

So in your experience in Orange County and in your school districts, you said that you were faced with a decision because of shrinking resources and because of your unique solution.

Would there have been, if you can think about a world that you would have liked to have been in, anything that the state could have done that could have helped you come to a better solution than you did get to because you had only your own resources?

MR. BERARDINO: Well, one thing the state could do is when they give local government programs is send the money along with it.

DR. GHILARUCCI: Okay.

MR. BERARDINO: But beyond that, I think local
control -- the reason why I think local control is important is because we are such a big and such a diverse state, and there's so many different issues that affect each group differently.

And also because our retirement plans themselves are very different, and they're already set in kind of a local arena, that without local control, you're giving up the ability to use the leverage from those individual retirement plans in terms of finding individual solutions that work for the jurisdiction.

DR. GHILARDUCCI: Yes, but there was nothing that you could have imagined that the state could have had available to you, like a larger risk pool for your retirees?

MR. BERARDINO: Well, that's --

DR. GHILARDUCCI: Or expertise that was subsidized, so you don't have to go out and hire your own actuary or your own lawyers?

MR. BERARDINO: We did that. And we did explore the possibility of, on the pension side, going with CalPERS and did a great job -- CalPERS did -- because we wanted to see if we were to pool, you know, would that have better economy for us? And we did have our own actuaries and we had PERS's actuaries. And all worked very closely together, found out that it did not
have a significant impact on us.

DR. GHILARDUCCI: All right, do you have any comments?

MR. HALL: Yes, ma'am. My comments on that, thanks for the opportunity to elaborate, is that we have the worst of both worlds in schools. We cannot raise funds locally. We can raise funds locally for school bonds for a capital purposes with a 55 percent bond, but we can't raise local property taxes that go to school schools. So we're tied to enrollment, we're tied to formulas that are rather archaic, that are way different, they're not equalized. We have a special ed. program in Capistrano that's a $75 million requirement based on local law and IEP's and attorneys and all the rest, and it's funded to the tune of $35 million. So we have the requirements in law and the local responsibility.

So I guess I would say that I wouldn't want to be left on my own in a local situation. As a matter of fact, that's where we are now. We need the support to be able to raise revenues locally. We need programs that are mandated by the state and federal government to be fully funded. We need some reform in declining enrollment, a soft landing over a period of years, as opposed to a one-year drop. And I would recommend the same kind of approach with any potential legislation in
OPEB, that if it's coming down the line and we're going
to have to fund the future liability, give us an
opportunity to have a soft landing on that over a period
of years.

Thank you.

DR. GHILARUCCI: My second question is in
another area. It's been said among pension reformers,
that pension reform is done by men for pensioners who are
mainly women. And so I have a sense that what I don't
know as a commissioner is who the retirees are.

What happens -- I only know anecdotally from
some of the public commentary -- to living standards
among your retirees when they have to pay for medical
care? Who, among retirees, are most vulnerable to cuts
in retiree benefits?

So if someone could tell me among the retiree
groups that you know, what percentage of them are women,
and how does their median income differ to the rest of
the population or to the rest of the retiree group?

MR. BERARDINO: I can respond to that. And
thank you for bringing that point up because I think it's
very important.

In the county workforce, roughly now, women
comprise about 64 percent of the county workforce. So
if you apply some logic to that, one guess would be that
we have a large majority, a majority who are women.

In our county workforce, the women, because we have a very large office services group, which comprises about 3,000 people of the 18,000 people, there's a large -- that group of employees are the least-paid of the entire workforce -- very, very difficult to move those salaries up -- who then have to come and live in Orange County and pay enormous costs for rent.

And so there is no question, I think, that the women are most adversely affected by the retiree medical.

CHAIR PARSKY: Paul?

MR. CAPPITELLI: Thank you. And I don't want to be the one to stand between us and lunch, but I do have a quick question.

CHAIR PARSKY: Two more, that's okay, and then we'll break.

MR. CAPPITELLI: Thank you.

Supervisor Moorlach, this question is for you, and this is in regards to your slide on issue number three, where you talk about life expectancy and decreasing retirement. I just had a couple of questions on that.

First of all, what was the basis for your remedy to go from age 50 to 57 for public safety members and for 55 to 62 for general members? How did you arrive
at that new number?

MR. MOORLACH: Thank you, Mr. Cappitelli.

We need to look at doing something -- there's already been some studies that show that if you can extend the time working at your employer, that it reduces the unfunded liability rather dramatically. We've done some research in my office. I don't really have a long answer on how those numbers were developed; but I believe that this would have a good -- maybe a good starting point for a discussion, but also a good way to start reducing our unfunded liability.

MR. CAPPITELLI: I guess more specifically what I'm really interested in is, was there consideration given to health, especially with respect to safety members? Because, you know, if you look back, historically, as to how we came to arrive at the formula for 3 percent at 50 right now for public safety, for law enforcement and firefighters, it has a lot to do with actuarial projections, life expectancies, things of that nature.

I guess my specific question that I really should ask you is, is the move from 50 to 57 a dollar-driven move or was there any consideration there for the life expectancy?

MR. MOORLACH: It's maybe a twofold answer.
But we are finding that from studies, that if you retire, and you retire sooner or earlier, you will live longer. That's one of the arguments for why you went from 55 to 50.

The second is --

MR. CAPPITELLI: I can't debate that. I would have to agree.

MR. MOORLACH: I'm just telling you we've got empirical studies that show it.

The second study is that if you are retired with a satisfactory income, you will also live longer. So these are just issues that -- you know, they just come out of data that you see.

I think the issues we're seeing, especially as you get into the upper echelons of police departments, where we're seeing that you are hiring for your police chief someone who is 46, 47, and while they're just in the job and really getting there, they turn 50, and then they retire, so you're losing some incredible wisdom, experience -- just what you need, as your chiefs, your captains, lieutenants.

Just recently my police chief retired, and embedded in the article, it says, "and on Friday, he turned 50." So I find it, as a manager, a real heartbreak to see some incredible people leaving so soon.
Now, you started out, I believe historically, 1 percent at 50, and it worked up to -- you know, after years, to 2 percent. A lot of anguish, and then overnight it went to 3 percent, just like that, and then it went retroactive.

So something is a little out of balance. And so I'm just here to provide some debate points and say, "What can we do, what can we put on the table," and whether it's something else, that's fine. But I think we should enter into dialogue.

MR. CAPPITELLI: I would just suggest to you that they're not all retiring; they're actually going to work back in the field, a lot of them. And they are taking that expertise and putting it towards somewhere else, which really kind of leads to my second question.

When you talk about or you mention double-dipping. Can you explain what it is and how it relates to the issue or the problem at hand?

MR. MOORLACH: Well, let me just give an example. My assistant could retire at 55. He could get 80 percent of his salary, and he walks in, and he says, "I'm going to retire." I cannot match -- I can't make a counter. One of the top guys in the state, in my opinion, and I can't make a counter, because how do you argue from that? Because he certainly could
work for a county next door and make the same salary he
was making for me, and then in a sense double-dip. Now
his salary goes almost double.

Getting back to even here locally, we're seeing
police chiefs that retire but are hired back on contract.
So we have police chiefs making well over $300,000 a
year. And that's in the paper. And the taxpayers are
kind of gulping, and they're saying, "So they retire at
55 and they come back and work for you as a consultant?"
There's a real disconnect there with the public.

The Sacramento Bee even came up with a study,
not only are they retiring, working somewhere else, but
they're also filing for unemployment insurance, and they
call it triple-dipping. So we're just seeing some
interesting issues that are surfacing that I think need
to be discussed in your efforts.

CHAIR PARSKY: Yes?

MR. PRINGLE: Well, if I could just jump back
in on that.

CHAIR PARSKY: Well, since your lunch has been
disturbed fully, you're allowed to come back.

MR. PRINGLE: Totally disturbed.

You know, I do like all this discussion about
local control issues, because I once was told that that
is a very conservative philosophy. And I look at a
conservative county.

Mr. Berardino, you like local control in the negotiations of contract for your bargaining unit?

MR. BERARDINO: Only in every case except when I'm bargaining with the mayor of the City of Anaheim.

MR. PRINGLE: But, I mean, do you have local control?

MR. BERARDINO: Yes.

MR. PRINGLE: Have you bargained for your bargaining unit a benefit of 3 at 50 upon retirement?

MR. BERARDINO: For --

MR. PRINGLE: Your bargaining unit.

MR. BERARDINO: We have one bargaining unit that we bargained with for 3 at 50.

MR. PRINGLE: Why not all the rest?

MR. BERARDINO: Because -- these are always loaded questions.

CHAIR PARSKY: We made him a little a grumpy, and that's why he's asking you this question.

MR. BERARDINO: Because there are restrictions.

MR. PRINGLE: Right. And the restrictions are placed locally?

MR. BERARDINO: No, they're not.

MR. PRINGLE: Therefore, there are restrictions placed on what is available at the state level,
therefore, they're parameters in all negotiations in terms of what is available as an option and what is available to be discussed within the box of local negotiations, thus the box of local control.

So there is not local control on all of the things that you may wish to consider in your negotiations; right?

MR. BERARDINO: That's correct.

MR. PRINGLE: And it's funny to me to hear a couple of folks from Los Angeles County today mention the desire to have greater local control; and then I heard a number of Orange County retirees come forward to say, "We wish there hadn't been the ability to have local control and possibly a state level of protection on what locals could do with retirement benefits for those who have already retired"; right? I mean, I heard that.

So it's an interesting argument on local control. And I know Mr. Kerr probably sees the same thing. Not everything is available for you to have, from your perspective or from your local government's perspective in terms of having an available for local control and local decisions; correct?

MR. KERR: Yes, I would agree with that.

And what the state has done to help us, we negotiated the benefits locally, and the state has
offered legislation to the Assembly, to the Senate, and through the Governor signing it, where we were able to invest it in a larger pool and double our return. And I thought it was a pretty good partnership between local government, local employees, and the state government.

MR. PRINGLE: And when I was in the Legislature, there had not been one -- I know Supervisor Moorlach pointed out preemptions or presumptions of cause, and the shifting of that presumption in terms of how they relate to firefighters and public safety employees. And those became legislative elements where the presumption shifted as to -- where that lies in terms of proving that cause of illness or injury. And those, therefore, took away that local control, or that local discussion. In fact, made a state directive, a state mandate; and certainly the Legislature voted for that. And the Governor signed those shift of presumptions; and, thus, that is not an available issue for discussion for local control as well. Is that right?

MR. KERR: Actually, administratively it is. I wish it was that black and white and that easy. But every firefighter who goes off on any type of job -- linked cancer or injury or dies in the line of duty or as a result of injury or illness, his family, his spouse, his folks have to fight for those benefits, whether it's
the federal public safety officer benefit, whether it's the state workers' comp benefit, and then going through the retirement system.

For all the folks that we've lost over the last decade, there has not been one easy blueprint of how it is done. And we had to set up our own 501(c)(3) to help families not only bury firefighters, because when they're killed in the line of duty, our employer didn't pay for the burial, but also to help the widow and the orphan to get through their mortgage for the next month or two and to buy them clothes to attend their daddy's funeral.

So a lot of those things that look really good on paper and it was done with intent of the best of intentions on both sides don't always play out in the real world that easily and that cleanly.

MR. PRINGLE: But in that regard, there was a legislative direction to change where those presumptions lie?

MR. KERR: Yes, you are correct.

MR. PRINGLE: In a number of those cases.

Thus making it easier in terms of those debates regardless of how difficult and challenging they may have been.

MR. KERR: Right. Well, I just want to
cherry-pick what works for me.

MR. PRINGLE: And I guess that's my point. And thank you for stating that.

MR. COTTINGHAM: Mr. Chairman?

CHAIR PARSKY: Two more quick questions.

That's all.

MR. COTTINGHAM: Actually, go back to Mr. Kerr, because I guess I missed the point about the defined contribution for the new employees.

MR. KERR: Yes, sir.

MR. COTTINGHAM: And I know you were a part of a group that I was also a part of that we went through the state arguing against the initiative that was coming up at the time, to switch all retirements to defined contributions.

How are you dealing with the death and disability aspect for your firefighters that are going to go into that?

MR. KERR: Say that again? I'm sorry.

MR. COTTINGHAM: Okay, when we fought against defined contributions, specifically over public safety, we saw that the largest flaw was death and disability.

MR. KERR: Understood.

MR. COTTINGHAM: And how are you dealing with that in your new employees that go into this program?
MR. KERR: The new program only deals specifically with retiree health care for new employees only. Everything else stays the same.

MR. COTTINGHAM: Okay, I guess I missed that.

MR. KERR: My apologies.

MR. COTTINGHAM: With Mr. Moorlach and Mr. Berardino, I think both of you are from a different Orange County, because Mr. Moorlach paints a picture of gloom and doom and what's happening, and you're suggesting you need to go to a defined contribution also. And then Mr. Berardino says everything is solid, it's been reevaluated, it's coming back.

But when you talk -- I think when you talk about the investments' footprint for defined contribution as opposed to what is happening now with defined benefits, I think that structure is going to be different, because that money is going to be dispersed throughout -- not into California, not held in deposit, but it's going to go throughout the United States and the different financial houses that these people invested in, and they're going to decide the investments, not your retirement or not CalPERS retirement board but those different financial houses. I don't think you're going to see that same investment return into California, into California's infrastructure.
MR. MOORLACH: That could be true,
Mr. Cottingham. But one of the things that I try to
emphasize as a board member of the retirement system, is
that the retirement system should be in the retirement
business. So now you have OCEA and you have the
firefighters investing their retiree medical funds into
the retirement system. So you have one money manager
that's overseeing the whole portfolio, and you saw
Mr. Berardino's graph on the returns that have been
generated the last 14 and a half years, so this is a
success story.

And Mr. Kerr has said it several times,
legislation that the Governor signed to allow for us to
put our trust funds in OCERS was rather dramatic and a
good, positive step forward.

I think if we offer a defined contribution
plan, I would strongly encourage those employees that
don't feel they have the acumen to invest their own funds
and diversify their own portfolio, do their own asset
allocation, make their own repositioning decisions, they
could put it in the OCERS portfolio, and it's already a
diversified and managed, and it has representatives from
the employees and the retirees on that board to make sure
that the management is being done in an appropriate and
thoughtful way.
MR. COTTINGHAM: So your solution is that the retirement board itself actually runs the DC plan?

MR. MOORLACH: That's what I would encourage, yes.

MR. COTTINGHAM: Okay, because I also read a report in the Washington Post within the last couple days that said there's Boeing International paper, Lockheed Martin, there's employee lawsuits over the excessive fees charged by the carriers of their DC plans.

MR. MOORLACH: Well, you wouldn't have those fees, if you had the monies inside your own retirement system that was local or use CalPERS as well for those municipalities that are not 37 Act counties.

MR. COTTINGHAM: Actually one final question, again for Mr. Moorlach -- well, a comment.

When you said these benefits changed overnight, it took 30 years -- the 2 percent formula came in, in 1968. It was almost 30 years before the 3 percent formula, or the other formula changes came in. The legislation was on the table for over a year, then things were negotiated. So I think it was not an overnight change that brought these things into play. And when you talk about having open disclosed negotiations, would you also advocate that our city councils and our board of supervisors have an open and disclosed discussion of how
much funds -- what the funds are available for employee
raises and benefits? Because now that's done in closed
session.

MR. MOORLACH: Just to respond to the first
question, Mr. Cottingham, I apologize for being a little
abbreviated in my response, but I've had a lot of
dialogue with public safety officials and, you know,
trying to get this history. And so I didn't mean to
sound flippant.

As to the other comment about bargaining and
open, I believe that's fair game.

MR. COTTINGHAM: Okay.

CHAIR PARSKY: Last question, Connie?

MS. CONWAY: Thank you, Mr. Chairman. I didn't
want to leave Mr. Danner out. And this question will not
compare to anything else you just heard.

I wanted to make sure I understood you
correctly because I'm not familiar with your hybrid plan
or, you know, I'm just hearing about this today. And I
wrote a note to myself.

Did you tell me that over half of the employees
that could choose to implement the new plan did so? I
was just looking for a statistic there.

MR. DANNER: No, I'm sorry, I may have misled
you. Approximately half of our employees either chose
the defined contribution plan or were forced into it by
the negotiations.

MS. CONWAY: Okay, that does make a difference.

Thank you.

MR. DANNER: But, again, I want to emphasize,
we came up with this age-plus-years-of-service breakdown
to try to make a logical separation. And at the end of
the day, it probably didn't matter because the people
that benefit by the defined contribution were those less
than 50 years old, age plus years of service.

So it was an artificial thing that we
developed, with very few exceptions, probably five people
fell out of the boundary of what would have made a
different decision, had they been able to.

MS. CONWAY: Had they been able to? That's
good. Thank you. I'm intrigued by this. It's something
new that I haven't seen.

Thank you Mr. Chairman.

CHAIR PARSKY: One last question. Sorry. One
last question.

MR. HARD: One last question for Mr. Moorlach.

You said that there's this double-dipping and
people leaving and then retiring and then taking other
jobs. And I've been a public servant since 1975 and was
wondering what percent of the workforce does that?
Because I'm not very familiar with it in my experience. I know it happens; but I just wondered, do you have, like a percent of workers that do that?

MR. MOORLACH: You guys are playing stump-the-band, and you're doing a good job. I do not have a percentage.

MR. HARD: I'm presuming it would be extremely small, but I don't know the number, either.

MR. MOORLACH: I don't know.

MR. HARD: Okay, thank you.

CHAIR PARSKY: Okay, well, I have totally failed at monitoring this process, but since I'm only about an hour and 45 minutes behind. However, I really appreciate this panel. It was very important, very important that the public hear the dialogue, very important your contributions.

We'll take 30 minutes for lunch. And I'll see if we can reorganize the rest of the day.

(Midday recess taken from 1:23 p.m. to 2:08 p.m.)

CHAIR PARSKY: We're going to postpone until our next meeting two items that are on this agenda. One item that begins at 2:30, relating to Background and Policy Principles for Public Employee Retirement Benefits; and with one exception, the Issues Facing Local
Governments as They Move Forward, so that we're not here until seven or eight o'clock tonight.

Ron Dole, we may want to ask to make a brief presentation.

And we're going to move now along the lines of the same agenda, but combine "Framing the Issue While Recognizing Unfunded Liability is Important," and "Implications of GASB 43 and 45 on Public Financing."

And we'll try to conduct this in about 45 minutes with questions for our panelists.

Michelle "Zerkowski"; is that correct?

MS. CZERKOWSKI: Close enough.

CHAIR PARSKY: Close enough?

Why don't you correct me then?

MS. CZERKOWSKI: It's "Churkowski."

CHAIR PARSKY: "Churkowski" -- Michelle Czerkawski is going to make the first presentation.

MS. CZERKOWSKI: Thank you, Chairman Parsky.

I am very pleased to be here this afternoon.

And thank you, Chairman, and Members of the Commission for inviting me to be here to speak about the role of the GASB, as well as its accounting standards related to post-employment benefits.

As the chairman mentioned, my name is Michelle Czerkawski. I'm a project manager on the staff of the
Governmental Accounting Standards Board, which we refer to as the "GASB."

Before I begin, I need to make our standard disclaimer that my comments here today are my own, and do not necessarily represent the official positions of the GASB. That board reaches its decisions only after a very formal and extensive public due process, similar to that with which you all are very familiar.

Today I would like to focus my comments -- and I had planned hopefully to take less than ten minutes of your time to allow for adequate time for an exchange. But I'd like to focus my comments really in three principal areas, and I will touch on a fourth.

First, I'd like to talk a little bit about what is the GASB, what is its role, what is its authority.

Second, I will identify the primarily relevant GASB standards related to post-employment benefits.

Third, I'd like to focus most of my comments on the philosophy or approach that underlies the GASB standards in this area; and within the context of that discussion, I will touch on a fourth area, which is the summary of required information.

So, first, what is the GASB? The GASB is not, as some assume, a federal organization. We are an independent not-for-profit organization that establishes
accounting and reporting standards for state and local
governments in the United States.

Our board is comprised of seven members that
are generally representative of our very diverse
constituency groups. Those groups include preparers and
attesters with regard to government financial records,
users of those financial reports, as well as members of
the academic community.

The GASB's mission focuses on issuing standards
of accounting and financial reporting that are intended
to improve government financial reports based on the
needs of users of our financial statements.

The GASB is considered among governments and by
the accounting industry as a source of generally accepted
accounting principles. However, we have no enforcement
authority to require adherence to those principles.

Enforcement typically happens through an audit process,
whereby auditors offer or render opinions on the fairness
of financial presentation with regard to generally
accepted accounting principles.

In many states, there also are state laws that
require local governments to prepare GAAP-basis financial
reports.

Very importantly, our standards are applicable
only to general-purpose external financial reporting.
It is not our purview, and we do not wish it to be our 

purview, to issue standards that relate to management 
decisions, relate to accounting or reporting for 
budgeting. And in the context of pensions and OPEB 
benefits, it's very important to note, as you probably 
all are aware, that we do not set standards that require 
any particular approach or method to funding or financing 
those benefits.

The board firmly believes that those issues are 
appropriately left in the hands of those that have been 
delegated that authority by the citizenry.

What are the pension and OPEB standards that 
currently serve as the basis for accounting and 
reporting? The pension standards, there are two of them. 
Statements 25 and 27 were issued in 1994. They address 
accounting for plans and employers, respectively.

Those statements have been in effect now for 
just about ten years. And the board currently has a 
research agenda on its project to examine the 
effectiveness of those standards with respect to meeting 
the needs of users of our financial statements. That's 
purely a research project. It's part of our strategic 
planning initiatives to automatically institute a review 
of that nature after a standard has been effective for 
ten years.
But I did want to mention that, as I understand that project was mentioned briefly by commenters at your last meeting. And if you would like any additional information about that project and how it is proceeding, we'd certainly be available to provide that to you.

The other two standards that form the basis currently and as we move forward for post-employment benefits are in the area of other post-employment benefits, benefits other than pensions. Statements 43 and 45 were issued in 2004. Those, again, address plan and employer reporting, respectively.

The OPEB standards, you'll note the ten-year difference in terms of issuance date. OPEB was originally part of the pensions project. But at the time the board did not wish to risk delaying issuance of standards on pensions, because it believed there may be issues that were specific to other post-employment benefits, specifically retiree health care and specifically in the area of measurement of those obligations, that caused them at that time to scope retiree medical benefits out of the pensions project. And so due to staffing considerations, et cetera, time has its way of getting away from us, the board actively picked up the OPEB project, again, in 1999. And that is what ultimately resulted in the issuance of the final
statements in 2004.

As you're aware, we are now hearing a great deal of talk about the ramifications of the information that is being required to be presented by the OPEB standards. The effective date for those standards is in a three-tiered approach.

The largest governments based on revenues will be required to begin implementing those in the fiscal years that they are currently in, or will be entering very shortly. Medium-sized and smaller governments have an extra one and two years respectively to implement those standards.

So what is essentially the foundation of the GASB's requirements? Well, OPEB and pensions, the board adopted the same general approach for both. And underlying this was the board's understanding or determination that, in their view, the transactions that were happening really had the same underlying substance. But, first, I'd like to mention that for planned reporting -- and I'm only going to say this very brief bit about that -- planned reporting focuses on presentation of stewardship information. And when I talk about planned reporting, I mean, reporting in the context of the trust, the fund that's being used to administer assets that have been set aside in the trust for purposes
of providing retiree pensions for OPEB.

With regard to employers, the board's approach really is based on a concept that pensions and OPEB are part of an exchange transaction between the employer and the employees. They are part of the compensation that employees receive for services provided to the government. Some of that compensation is paid in the period of active service, salaries and active employee health care, for example. Pensions and OPEB are different in that the compensation is not actually paid out until the period following the active employment period.

Nonetheless, the board views these as a compensation for services, and believes that the cost, or at least a part of that cost, should be recognized in each period that the employee is rendering those services to the government, so that the government can, in a most transparent way, present to users of their financial statements and financial information, information about what the total cost of providing government services is.

To achieve this, the standards set up some parameters. The information that’s required to be presented in the financial statements is based on actuarially calculated amounts. The amounts that are reflected in the actual financial statements of a
government -- the statement of assets, the statement of changes in those assets -- are, first, based on an expense amount. That expense amount, again actuarially based, includes an amount to recognize on the cost of benefits that are being earned by current employees in the period, as well as a piece of the amounts that have been accumulated over past service but have not yet been brought onto the face of the financial statements.

It's important to understand that the total amount that's required to be recognized as a liability, an accounting liability, to be clear, is not the full amount of the unfunded actuarial liability that is calculated.

The liability that is reported is the cumulative difference between the amounts that are expensed and the amounts that are contributed to a plan, a pension or OPEB plan. By "contributions," I mean, transfer of cash to a trust or by direct payment of benefits to retirees.

The information about the total actuarial accrued liability, the unfunded portion, the relevant assets, actuarial value of assets, and several ratios are required to be presented in the financial reports but not on the face of financial statements. That information is included for the current year's information in notes to
the financial statements; and there's a multi-year
schedule of funding progress that's presented as required
supplementary information.

I'm not sure how close I am to using all my
time.

CHAIR PARSKY: That's okay.

MS. CZERKAWSKI: I would like to just mention
that for plans there are two financial statements.
There's a series of required note disclosures to provide
some context on to the activities of the trust, and then
there are supplementary schedules.

I've provided a great deal of information about
the actual accounting requirements here. It is at a high
level, but it's relatively detailed so I'm not going to
go into that.

I think I touched on the main points, being the
difference in the recognition requirements and what is
disclosed.

The boards believes, however, that it's very
important to have information about that total actuarial
accrued liability because it can be indicative -- it is
indicative of potential future cash-flow demands on the
government; and it's part of the big picture that the
financial statements are trying to convey.

And so with that, I will cease speaking.
And I'm not sure if you'd like to turn it over to my colleagues first or --

CHAIR PARSKY: Yes, I think if we can do the other presentation, then we'll come back and ask questions to all three.

MS. CZERKAWSKI: Thank you.

CHAIR PARSKY: And the next topic is: The implications of GASB 43 and 45 on Public Financing.

Parry Young. Is that right?

MR. YOUNG: That's right.

Good afternoon, Mr. Chairman and Members of the Commission. I am Parry Young. I am a director in the Public Finance Department at Standard & Poor's. And I'm going to try to put a bond-rating perspective on the issue of retiree benefits.

Some of the points in my presentation have been already made today. I'll try to go quickly through those. Some of them are still original. But luckily, I'm the only person in the building that can tell you what S & P thinks about retiree benefits.

CHAIR PARSKY: That may not hold true for other subjects; but that one, it does.

MR. YOUNG: That's the one that I have a corner on.

Just to emphasize where we're coming from, we
do these issue credit ratings, and it's an issue-specific
opinion of an obligor's creditworthiness with respect to
a specific financial obligation.

Here are some examples around California, with
the State's G.O. bonds at A-plus. Orange County lease
revenue bonds at A-plus. Los Angeles USD G.O.'s at AA-.
San Francisco G.O.'s at AA.

"A" category generally denotes a strong
capacity to pay principal and interest, and "AA" category
is very strong.

S & P was founded in 1860. We had been doing
ratings for about 80 years. I haven't been doing them
all of that time.

We have ratings on thousands and thousands of
municipalities throughout the United States and around
the world.

My remarks on government retiree benefits
reflect the credit ratings perspective and the expression
"likelihood of repayment -- capacity and willingness of
an obligor to meet its financial commitment."

A little preview. I'm going to talk about --
we pretty much hashed over what the issues are, and I'll
go through that quickly, and then the global impact of
retiree benefits and then a survey we recently did on
state pension funding and how California fits in there,
developments in the OPEB world on retiree health care, and looking at some strategies for managing retiree benefits and fiscal effect of these retirement benefit pressures and what the credit implications might be.

Two good points, though, on pension liabilities -- we're talking about the defined benefit plans, which is most public plans in the United States -- the challenge there recently has been the plummeting funding levels and the correlation of the increasing contribution rates.

On OPEB, GASB 45 is focusing attention on the funding of these obligations and the challenge there is to manage them effectively under the new accounting rules.

But we're not alone. It's a global issue, driven by demographics, mainly the aging populations. By 2050, the world's average age will be 38 years, ten years more than it was in 2005. Fourteen countries, mainly in Europe, will have a median age of 50 or more. And the worldwide dependency ratio, that's the population of 60 and more, will surge to 45 percent by 2050, compared to only 19 percent in 2005.

The effect of this aging in various countries, the age-related spending, unless they change policies, these countries will suffer fiscal pressures on their
finances.

France, the age-related spending of the percentage of GDP will go from 23 percent to 27 percent. In Germany, 20 percent to 23. In the UK, 15 to 19 percent.

And right here in the United States, it's going to increase even more dramatically. And this assumes no changes in policy are made, that will go from almost 10 percent of GDP to almost 20 percent by 2050.

Recently, in February, we completed a survey of state public funds as of 2000, and found the funded ratio is about 82 percent in 2005. And that compares to over 100 percent on average in 2000.

Right here in California, the CalPERS PERF in 2005 was 87.3 percent funded and CalSTRS, the defined benefit plan, almost 86 percent. And the unfunded liabilities, almost $47 billion there. Now, but California is a big state. On a per-capita basis, the unfunded liability is about $1,300 per person, compared to the average in the United States of about almost $1,400.

On the OPEB front, Michelle has spoken eloquently about this. And some of the points that I would like to make, it's to emphasize that the new reporting will recognize these costs and the periods when
they occur on an accrual basis. But it will also provide information on the total liabilities and the extent to which they're funded.

And then also information on future cash flows, which in the rating business, we're very interested in, in these issues.

Before GASB 45, it was on a pay-go basis, the long-term liabilities had not been determined. We didn't know what they were, and the projections of those future costs were totally unknown.

Reporting the actuarial valuation would provide a lot of good information. The annual required contribution, the amount needed to fund this on an accrual basis would be reported.

And then the net OBEP obligation, the difference between those, between the ARC and what's actually paid will be determined. And, of course, GASB does not require the funding of these obligations, just a reporting on them.

This is a hypothetical example of what these payments might look like. The blue is the pay-go where you can see the ARC going up, driven by aging and early retirements and medical inflation. And then the red line is the ARC, which is a little flatter curve. It might be easier to manage.
Although in this case where the ARC is about two times the initial pay-go, in reality, we're seeing multiples of six, seven, eight, nine times.

Some selected OPEB liability cases here in the state, 40 to 70 billion, an estimate. Los Angeles, 800 million. And they have funded more than half of their liability. LA Unified, 10 billion, and San Francisco, three to five billion.

There are basically only two ways to manage an actuarially funded plan: You have to play with the assets or the liabilities. And the balance is not easy, especially when you're starting with no assets.

To increase assets, you can increase employer contributions or introduce or increase employee contributions.

Alter asset allocation strategy, although most public funds are very professionally run and there's not a lot of juice left there.

You can issue pension obligation bonds or OPEB obligation bonds, and then insert assets in there right away and get some investment income flowing.

Strategies to lower the liabilities might include:

Reducing benefits if legally or politically feasible.
Close plan to new members. Create a new tier with lesser benefits. We've seen this a lot in the pension area.

Cap total employer benefits -- that's both pension and OPEB -- and convert defined benefit plan to DC plan, as was mentioned this morning.

On the DB/DC conversion, a couple of important things there. You would shift the investment risk from the employer to the employee. And the final benefit is no longer fixed or predictable.

In the private sector, since ERISA in 1974, there's been a tremendous increase in DC plans and the DB plans have gradually gone away.

The fiscal effect of the retiree benefit pressures include the annual contribution rates that have increased dramatically during this decade; but now they look like they're going to moderate a little bit if investment returns meet assumptions and liabilities are kept in check.

If contribution rates remain high or increase, they will add to fiscal stress.

On the OPEB front, in many cases where the government has significant OPEB liability, there will be OPEB cost pressures just based on the demographics of medical inflation.
In places where the increases are material, budgets may be strained.

As far as the credit implications of pensions, we've incorporated these liabilities and payment streams into our ratings for a long time, and excluding any unusual event with an individual system, we'd expect asset volatility to more or less affect pension plans rather uniformly, as it did in the 2001-2002 investment loss scenario.

Based on the experience over the last several years, contribution rates could start to level off or decline if funded ratios improve.

Should either poor investment returns or liability growth cause contribution rates to again increase rapidly, this development could become a rating factor especially for weaker credits.

As far as the credit implications for OPEB, unlike pension liabilities, this is new reporting information that we did not know or anybody knew about before about these liabilities and costs. We're seeing a wide range in OPEB exposure as the actuarial valuations become available from little to no liability, to huge unfunded liabilities with large annual required contributions relative to current pay-go's.

We expect most employees to be able to continue
to meet their ongoing OPEB cost requirements without adverse effect on credit quality over the near term.

And that concludes my comments. Thank you.

CHAIR PARSKY: Thank you very much.

Dari Barzel.

MS. BARZEL: Thank you.

CHAIR PARSKY: Is that right?

MS. BARZEL: Can you hear me?

CHAIR PARSKY: Speak into the microphone and you'll be fine.

MS. BARZEL: Okay, thank you.

CHAIR PARSKY: Is your green light on there?

MS. BARZEL: Much better. Thank you.

CHAIR PARSKY: You're welcome.

MS. BARZEL: Yes, I'm Dari Barzel. I'm with Moody's. I'm also with a bond-rating agency. I thought I would focus a little bit more on OPEBs themselves -- since that's the new gorilla in town -- and let you know how we're looking at those.

I wanted to step back a little bit, though, and let you know what a bond-rating agency does and how we do what we do.

A bond-rating agency assigns rating to local government bond issues. That's my job. I focus on local governments in the state of California.
We are evaluating the issuer's ability and willingness to pay.

One fact that is very important is that all of our bond ratings are relative, meaning, that we're comparing cities against other cities.

This is a very crowded slide, which basically talks about the fact that we did an analysis of default rates among local governments; and we determined, to nobody's surprise, that default rates among local governments and governments in general, is much lower than that of corporate entities. Of course, governments are able to pay, and governments are able to pay much better than corporate borrowers are.

We could have just said, "Okay, well, then everybody is AA or AAA and let's all go home." But that was not of interest to the investors in the bonds. Investors in the bonds wanted us to make a little bit finer distinction among local government entities. So from the get-go, it is assumed that an A-rated government is going to be able to pay its obligations better than an A-rated corporation. It's a completely different scale.

Having said that, what are our fundamental rating factors? What do we look at in municipal governments? We look at, we call them, the four factors: The economy and tax base, finances, debt level and debt
structure, and management.

The OPEB liabilities do affect three out of four of those factors. They're just one aspect of all of those factors.

My presentation, which I've made in various forms over time, has been designed primarily to address the panic in the eyes of bond issuers who get very, very concerned that the actuary is going to come back with a big number and then we're going to downgrade them. And that's not the situation, and I'm going to be explaining why.

First of all, we do believe that OPEB disclosure is a very good thing, in large part, because it enables local governments to understand the magnitude of the promises that they've made, it enables local governments to decide how to address those promises, and how to make decisions going forward. So everybody has a much better understanding of where we stand right now and how the future might look, absent any changes, and how to make those kinds of changes.

We understand a large number of things about the OPEB, that issuers just don't need to worry about. We understand that typically in the past, governments have provided fairly generous benefits. Governments have not prefunded those benefits. Governments routinely have
operated on a Pay-Go basis, and that's been fine. We do understand that the OPEB numbers result in a very large present-value obligation. That's fine.

A typical OPEB exposure is already built into the ratings, kind of by definition because, as I said, all of the ratings are compared to each other. So a standard obligation, the median obligation is already in there. We're going to look and see over time if your obligation turns out to be much lower than somebody else's, you're doing great. Much higher than somebody else's, you might have a problem. But the median, your average entity with your average obligation, it's already in the rating.

The other thing is that even if the OPEB obligation is converted into debt tomorrow, if you take the $3 million or the $30 million or the $300 million and turn it into debt, you pay it off $3 million a year, chances are you can afford the $3 million. And an OPEB obligation, like the pension obligation, like a pension obligation bond or like any other debt is an annual obligation that you pay over time. And we can look at it that way.

And the back-of-the-envelope calculation, we have looked at it that way. It's not formal, but that is how we're looking at it right now.
The most important thing right now is, what is the government's response to the number that they're being presented with? How are they evaluating what the current situation is and what are they going to be doing about it?

Right now, it isn't very, very early. The standards haven't been implemented yet, never mind finding consistency across governments and consistency of responses. Right now, what we're mostly looking at is, where is a particular government on the learning curve? And the learning curve starts with, "What's OPEB?" Which somebody had asked me recently. And it goes all the way through, "Well, we're not quite ready to do an actuarial study but we're going to," or, "We've done one, and we know we have to do something about it, but we don't know what," or "We looked at all of our various alternatives, and these are the things we're going to implement" or "we've begun implementing."

I mean, that seems to be the standard -- you know, where you might be on the learning curve. And different government entities are at very different places along there.

In the future, likely ways in which we might focus on the OPEB liability, to decide whether or not it is a problem, we might normalize it against payroll.
We might normalize it against budget, against revenues. We might normalize it against the tax base. Again, all in order to provide us a basis for comparing governments against each other, which is what we do. We might look at OPEB costs as a percentage of the budget now and going forward, assuming certain assumptions are held steady over the course of time.

The assumptions themselves are going to be very important. And the actions that a local government is taking in order to control their costs, those are going to be very important to us as well, whether the government is looking at changing benefit levels, whether it's considered that as an option, whether it thinks that's a good idea, whether it has the assets to prefund and is choosing to prefund. We don't have any preferred alternatives. We just want to understand that the local government is thinking about it, is addressing the problem, and has come up with what is a rational solution from its own perspective.

Over the long-term, OPEB liabilities may lead to rating changes, as I said earlier. Over time, it will be determined what is a normal, what is a standard; and over time, it will become clearer if you're doing better, if you're doing worse than average which could, in the end, lead to a rating change.
The final thoughts. In the short-term, there is not going to be a need to fund the OPEB liability in order to maintain a rating. That may change over the long-term, but it's not going to happen immediately.

And people do ask us about OPEB bonds. And I do have to say that OPEB bonds, it's funny for me to say that in and of themselves they're not a credit negative. It's funny for a bond agency not to like debt. But as a matter of fact, you know, the more debt you have, the more of a credit risk you may be perceived to be. So we say, "Okay, an OPEB bond in and of itself is not a problem, as long as it's part of a very carefully crafted solution, as long as it's clear that you understand what your liability is, and it seems to make sense as part of your overall plan.

Whenever bonds are issued, an issuance of a bond results in a lack of flexibility because all of a sudden you now have fixed payments to be made over the next 30 years as opposed to without the bonds, there may be more flexibility. If you've evaluated that, you understand what you're giving up in order to get what you're getting. Bonds can be okay with us.

That's it.

CHAIR PARSKY: Thank you all very much.

This is somewhat of a complicated subject, but
why don't we open up to questions from anyone on the --
yes, Curt?

MR. PRINGLE: I would just like to ask

Mr. Young after hearing the Moody's presentation or the
representative from Moody's. Is there a distinction that
S & P has made in terms of -- would you say there's a
different view on that liability in consideration in your
ratings? I mean, are there nuances that the rating
agencies are considering between the three agencies?

MR. YOUNG: I think you have to decide that.

I'm not really familiar with Moody's criteria on this.

MR. PRINGLE: Therefore, in terms of your
criteria, what would be unique considerations that you
would put into place in terms of making those credit
evaluations?

MR. YOUNG: What would be unique?

MR. PRINGLE: Or what are yours, what do you
consider within S & P when you provide for that rating?
Do you look at anything any different than what you just
heard?

MR. YOUNG: I wouldn't say a whole lot
different, no.

MR. PRINGLE: Is there a challenge at this
moment in time to be able to have this agency-by-agency
comparison in order to be able to look at that, and,
thus, some of those challenges may be addressed with
greater reporting that may move forward with the GASB
standards?

MR. YOUNG: Well, I think as more information
becomes available, then I think a lot of these questions
will be able to be fleshed out.

MR. PRINGLE: All right. You're really
tight-lipped.

Thanks.

CHAIR PARSKY: We'll try to loosen him up a
little.

Teresa?

DR. GHILARDUCCI: Yes, exactly on that, maybe
to GASB, is there an actuarial --

AUDIENCE: We can't hear.

DR. GHILARDUCCI: Is there an actuarial method
that you prefer? Projected unit cost --

MS. CZERKAWSKI: I'm glad you asked the
question. I was chomping at the bit to jump in as Parry
was speaking.

Strict comparability among governments will not
be as easy as some would hope. The GASB's parameters
that are established in both the pension standards and
carried forward in the OPEB standards are very flexible
in terms of the methods and assumptions that may be used.
The parameters rely very heavily on actuarial standards of practice, and that's primarily because of the complexity of the measurement model.

They do establish some guidelines within which methods and assumptions must be chosen. But, for example, the standards do allow a choice of six actuarial cost methods.

In the pensions environment, where most pension plans were funding -- advance funding at the time the standards were issued, some may think that makes more sense than the OPEB environment. But, you know, it's yet to be seen what's going to materialize in that area.

Oftentimes, the standards have been referred to as somewhat funding-friendly because of that flexibility. The board really relied very heavily on the actuarial standards of practice, examined the methodologies that are acceptable under those standards, and did weed some out in terms of, for example, cost methods the Board did not feel that they were consistent with the concepts of accrual basis accounting.

For the others, they saw no reason to deviate from what's considered an acceptable actuarial cost method for funding purposes, given that it is consistent with our concepts.

And so they thought that there was some
usefulness in information, since the information in financial reports as presented on a consistent basis with that which the government is being used for management purposes.

DR. GHILARDUCCI: So you don't take a more activist view? You don't have a best-practice list or a preferred methods or even a survey of what is being done?

MS. CZERKAWSKI: We do not establish best practices in this area. As part of our pension research project, we currently are obtaining information about what currently is being done in public pension practice.

DR. GHILARDUCCI: Not in retiree health?

MS. CZERKAWSKI: Not in retiree health. Primarily the information is not out there because it's been done on a pay-as-you-go basis for the most part.

Oftentimes when governments and government officials -- this is a very complicated subject, as we all have come to understand, and oftentimes, particularly if you're not advance-funding and may not be planning to advance-fund perhaps for quite a long time, and that's perhaps a perfectly acceptable funding methodology, then you may very well for financial-reporting purposes select the same method that you use for pensions because you have some base knowledge about how that method functions.

DR. GHILARDUCCI: This is also sort of a
blue-sky question, but half of public employees in California don't have access, or maybe it could be up to half don't have access to Medicare.

In your experience, just looking at other states, how much does that matter in terms of -- just your sense of it -- how much of a liability California is carrying versus other states that have full Medicare coverage?

MS. CZERKAWSKI: Is that directed at me or -- I really can't --

DR. GHILARDECCI: I'm looking at all of you guys.

MS. CZERKAWSKI: I'm hoping it's directed at someone else. I really don't have any data to support a conclusion on that.

DR. GHILARDECCI: Perhaps your colleagues have.

MR. YOUNG: There are other states that are in a similar position.

DR. GHILARDECCI: Massachusetts and Texas.

MR. YOUNG: And when they were talking about making all states go onto Social Security, as they would periodically do, that would have been -- could have been a serious credit issue with all the increased contributions to Social Security. But as far as your OPEB thing, it's a little difficult to measure yet; and
we don't have the numbers yet.

DR. GHILARDUCCI: Yes.

Do you have an opinion on that?

MS. BARZEL: I could only agree that it's early yet.

DR. GHILARDUCCI: Okay. But you also agree that when we were talking about universal coverage and Social Security, that looked like a liability issue with the states and a credit issue for states? It didn't help.

MR. YOUNG: Mandatory Social Security, yes.

CHAIR PARSKY: Yes?

MR. COTTINGHAM: So as I understand it then, there's no real set formula or best practices for determining your OPEB liability?

MS. BARZEL: I would not put it in exactly that way.

What I would say is that we rely on actuarial standards of practice. The actuaries do have established standards through due-process procedures, et cetera, that do set some parameters around the measurement process.

Our standards, in addition, put another layer of kind of guidelines and parameters on top of that.

MR. COTTINGHAM: But could two cities or two entities with the same financial or fiduciary issues come
up with different liabilities?

MS. CZERKAWSKI: I believe that is possible.

The actuaries -- and this is the best kind of deferral -- but there are some actuaries on the panel following ours, that are scheduled to speak, and they may be able to put some better ideas in terms of the magnitude of those differences. But, yes.

MR. COTTINGHAM: And with the liability, when it comes to bonding -- because this is where it seems to be the biggest issue. I mean, since this is a nationwide issue and every entity, municipality wants to have a good credit rating, wants to make loans; bonding houses, financial houses want to issue credit, what is going to -- maybe you can't answer this -- but what is the determining factor that's going to tell you when -- you know, obviously, if an entity does nothing, they're not going to fare well when they're trying to get a bond or get their credit rating. So what is the real determining factor in bonding or in getting credit that's going to make one entity stand out over another that they're not actually addressing the issue as well as they should or that they have actuarially or in their accounting have not reported it correctly?

MS. BARZEL: I was going to answer the question not from the actuarial perspective but from the
managerial perspective. Because at this point in the redevelopment of the OPEB process, I think that's where we are.

It's not really a matter of -- as long as they got an actuarial report that is compliant with actuarial standards, and as long as the assumptions within that report appear somewhat reasonable on, you know, whatever basis they choose to present those, again, we don't yet have nationwide standards to determine what's reasonable and what isn't, so they must have some experience that they can throw at the report and come up with some kind of valuation.

The most important thing is the fact that management is willing to understand the number when it comes back, what that number represents, whether or not they want to fund that number, at what level, for what reason, and how they're going to go about addressing the situation.

There are local governments that have an enormous number -- you know, OPEB number that have not faced the question of, "So what do I do now?" I mean, they're in a position that's very, very difficult. If they can't renegotiate the benefits, that's difficult. If they don't have the assets to put against the liability, that's difficult.
At this point, I'm not going to lower their bond rating as a result of that fact. I'm going to note that. I'm going to actually write a little paragraph in the report saying, "It looks like they're going to have a problem." Over time, over the course of few years, as other people are finding solutions, if these guys still don't have a solution, then it's going to start making a difference.

MR. COTTINGHAM: Okay.

MR. YOUNG: I think as far as the actuarial methods, I think we'll have to follow the pattern of the pension arena to a large extent, at least initially, where most public pension funds use entry-age normal and some use other methods, including the aggregate which doesn't report an unfunded liability. But as long as they use a consistent actuarial method and have good reasons for using that method, we rely on them for their consistency.

And as far as where the government has to get -- I think you were asking, where is the point where we lower the rating; is that basically what you're getting at?

MR. COTTINGHAM: Yes.

MR. YOUNG: But we're not going to be in a position to set public policy or tell a government
what percent of their costs should be spent on benefits for either pensions or OPEB. They have to manage that within their own policies.

But where it comes to the point where it crowds out their ability to pay debt service, that's where it's going to have an effect on credit.

And I couldn't possibly tell you where that is right now.

MR. COTTINGHAM: It seems like each one would be different, I guess.

MR. YOUNG: I'm sorry?

MR. COTTINGHAM: Each entity, I guess at that level it would be different.

MR. YOUNG: Exactly.

MR. COTTINGHAM: Okay, thank you.

CHAIR PARSKY: Dave?

MR. LOW: On the pension unfunded liability issue, we've seen a variety of pension funds with various unfunded liabilities ranging from 69 to over 100 percent. And I often hear descriptions of the same unfunded liability on one side as, you know, 90 percent unfunded liability is this huge unfunded liability, it's a ticking time bomb; and on the other side say it's a fiscally sound system, 90 percent is good.

So give me a perspective on how you evaluate
the unfunded liabilities of these pension funds that are
in that neighborhood.

MS. BARZEL: Are you looking at me?

MR. LOW: Any of you.

MS. BARZEL: I'm happy to do that.

Again, what we tend to look at is, over time,
a history over time. We can understand it at any
particular moment. If the stock market just crashed, all
of a sudden your funding level will have just crashed
as well. So there isn't a specific number, it's not
going to be 60 percent, it's not going to be 70 percent.
It depends on the moment where they are as far as the
market situation.

Also, it matters over time, over, you know, the
course of five, ten, 15, 20, 30 years. If they have been
consistently underfunded for a very extended period of
time, then, obviously, that indicates that there has been
a problem.

We expect there to be normal variations.
You're underfunded sometimes, you're overfunded
sometimes. That's pretty much how it goes.

Another very important factor, though, will be
whether the local government has been making its
actuarially required contributions along the way. I
mean, that's a more important factor in the long run.
MR. LOW: So let me just get to a more specific case. Let's choose CalPERS as an example. They, before the stock market crashed, they were at 130 percent. They dropped down to about 87 -- you know, 85 percent afterwards. They've recovered to a +90 percent now.

How would you rate their system?

MS. BARZEL: I wouldn't rate CalPERS’ system. I know what I can tell you is that we are very comfortable with the pension situation of participants in the PERS system. And part of the reason is that it's our understanding that PERS does impose discipline. Anybody who participates in the PERS plan is going to be making payments and is going to be making payments that are consistent with a fully funded system over a long period of time.

MR. LOW: And on the GASB unfunded liability, it seems to me there's a lot of factors into continuing pay-go on the short-term basis over the long-term, many of which are, for example, lack of enough vehicles, I know that there's discussion right now about whether CalPERS would be available to non-PEHMCA agencies, you know, their bargaining process, the fact that we have a three-year phase-in and a lot of people haven't even done the actuarial study. So it would seem to me that on the short-term, there wouldn't be dramatic changes.
What is the sort of timeline you're looking at as to -- do you have a ballpark on when you might be able to start making a more comparative look at agencies?

MR. YOUNG: Well, I think that reporting is only due for most large governments on June 30th, 2008, it's going to take a while before this information starts to come out. And I think it's going to vary.

I mean, the political process and the legislative process varies from government to government. So we don't have any real deadline. We want a plan and progress and moving towards that plan.

And getting back to your earlier question about the funding levels, we also look at what is happening with the contribution rates that came down all through the nineties and even through 2002, and then spiked up after the investment losses in 2001 and 2002. We look at how the government is managing that contribution rate volatility. So that's another aspect.

Rather, the unfunded liability is a number out there. But where the rubber meets the road is what contribution rates are being made today and over the next several years.

MR. LOW: Right. So getting back to the GASB, would it be fair to say that -- because I think a lot of agencies are -- when the number comes out, the tendency
for some is to press the panic button because the number
is big.

So would it be fair to say that there is no
reason to press the panic button, that there is some
time, that they have a reasonable period of time to
evaluate it and formulate decisions on a sort of rational
basis as opposed to rushing in to taking immediate
action?

MS. BARZEL: From my perspective, I would say
absolutely as long as they are addressing the question.

Like I said, anybody who at this point is sort
of saying, "What's OPEB," or "Well, I think we're going
to have a study soon," or "We've had a study, but we're
going to wait until our next study," that's not facing
the issue head-on.

On the other hand, as long as somebody is
taking steps towards addressing their issues, but that it
might take a year or two or three to come to a nice,
comfortable, steady state, that's something we can
completely understand.

MR. LOW: Thank you.

MR. YOUNG: And I think I can agree with that.

CHAIR PARSKY: John?

MR. COGAN: Thanks, Gerry.

Thank you all very much. It's very
informative.

And thank you, GASB. You've done a wonderful public service with this circular. I think it's going to be a real wake-up call for local governments around the United States.

I wish S & P had done something, and I wish Moody's had done something; but we are where we are.

I want to go back to the measurement question. We had established that GASB allows the localities to have broad latitude in choosing their assumptions, choosing what discount rate they use, choosing the assumed level of health-care cost growth. And one of the issues that's going to come before the Commission is, do we stay with where GASB is, or do we issue a more prescriptive set of standards that localities should follow in measuring their own unfunded liability?

So you can't answer that question for us. But maybe you could inform us a little bit as to why you stopped where you did. Why didn't you go further and try to be more prescriptive?

The same thing with the other panelists. Why wouldn't you be more prescriptive? Is it politics or is it a lack of substantive knowledge about health-care cost growth or what the right discount rate is?

So Michelle, do you want to start?
MS. CZERKAWSKI: Yes. I mean, first of all, I think that the Board's standards couldn't be that specific because it does vary so much, depending on types of benefits that are provided, et cetera.

Just somewhat as an aside, but I believe it's relevant, the actuarial profession has been dealing with measurement issues related to retiree health-care benefits for a long time, much longer than the GASB has even been discussing OPEB issues, and that's a pretty long time.

With regard to methods -- for example, actuarial cost methods -- the board decided on the OPEB side, it did really consider whether, given the state of advanced funding on an actuarial basis -- or the lack of it, I should say -- whether it should restrict the options for financial reporting on the OPEB side. It decided instead that consistency with pension reporting, in essence, would kind of carry the day in that regard. Again, relying very heavily on actuarial standards of practice.

The other example that you gave was selection of a discount rate. I'm not going to imply that we have anything set in black and white to guide that assumption. Actuarial standards of practice do guide that somewhat. The board does set some parameters around that. It is
supposed to be selected on the basis of the expected rate of return, long-term, on the assets that are going to be used to fund the benefit, finance the benefits.

Now, that's a pretty broad range, particularly given the mix of assets that may be used.

If you're currently on a pay-as-you-go basis, that's the rate of return on government's general investments, which typically is very small. And, therefore, you're going to have a much larger actuarial accrued liability in that circumstance.

If you start to set funds aside and fund on an actuarial basis, then you get to use a discount rate that's something blended. If it's not fully funded in accordance with the funding -- you know, funding policy does not anticipate full actuarial funding, then it's a blended rate. So I'm not going to sit here and say that we narrow it much. We do narrow it some. But, yes, there is the potential for great flexibility in those. And the board just could not find reasons at this point in time to narrow it.

Obviously, the state of affairs is something that the board will keep an eye on. Given the ten-year time frame in terms of the standard review, it's going to be quite a while given that the final governments won't be implementing until sometime in 2010 for the
smallest governments, but it is something that staff will continue to monitor.

MR. YOUNG: But there are some checks in reasonableness on the discount rate assumption and medical inflation assumptions.

We ask questions all the time from pension funds: Why, are you assuming a 9 and a half percent return and everybody else is at 78 percent? You know, show me. So there's that kind of thing.

And also on the medical inflation, if you're assuming 3 percent, we're going to ask you why, what's going on there? And where do you live? There are some checks.

MS. CZERKAWSKI: If I could make one extra point, I think it's very important to note that the standards do require disclosure of the actuarial methods and assumptions so that, now, granted it does require some pretty specialized knowledge about how these things are measured; but you could, armed with those and perhaps some experts or people who have some familiarity in the area, start to question some of the numbers.

The board firmly believes, however, that the numbers that are derived with the accompanying no-disclosures are better than no numbers at all.

MR. COGAN: Right.
CHAIR PARSKY: Dari, do you have anything to add?

MS. BARZEL: Not particularly. The only thing I would say is that I think were we to describe parameters that would be coming awfully close to setting public policy, which is something we very much would like not to do, we prefer to analyze and review.

MR. COGAN: Thank you.

MR. BARGER: Parry, you had a chart in here that shows a hypothetical graph of pay-as-you-go versus the ARC.

And the question I had on this was, what are the implications of staying on the pay-as-you-go line, to what that ARC line looks like, and when the lines cross and then sort of come back?

MR. YOUNG: I don't know where the line was, but the pay-as-you-go scenario, the do-nothing scenario is simply trying to illustrate, GASB 45 did not invent OPEB. It's been around for a long time, and will be. This just shows what the effects of medical inflation and demographics are hypothetically on a very fast ascending line. And the ARC is on an accrual basis, how to fund that liability.

That, I just made up in my Poor's work -- you saw the Poor's PowerPoint work, but I did that all
MR. BARGER: My question sort of relates to sort of a you-pay-now or you-pay-later sort of thing. And what does it cost you in a sense to say, "I'm going to stay on the pay-as-you-go line" to that future ARC, which obviously the longer you wait, the higher it goes?

MR. YOUNG: Yes, if you stay on it -- I mean, if OPEB is 1 percent of your budget today and in seven years it's 3 or 4 percent, and in 12 years it's 12 percent, you know, there are going to be a lot of people asking questions as to how you can manage that. That's all that graph was really meant to show. And that the ARC can actually bring down -- can arrest that Mt. Everest slope.

MR. BARGER: Is there a presumption over what period of time either rating agencies or GASB is looking to sort of have the issue resolved, if the issue is resolved in the sense that the ideal is that it's funded? Is it something that's supposed to happen in 30 years, ever, or --

MR. YOUNG: Well, it's 30-year amortization under GASB. But as far as the resolution, from our perspective, we don't really have any time horizon.

MS. BARZEL: I was just going to add that I don't think that "resolution" is exactly the right word.
because it's not something that is there and is going to go away, it will be done with. It will become a normal part of doing business, the same way as pension funding is. It might become more normalized, people might understand it better, might get it to a size that they're comfortable with and be able to budget for the future better; but I think that there will always be OPEB in the same ways there will always be pensions.

CHAIR PARSKY: Yes, Lee?

MR. LIPPS: Ms. Czerkawski, does GASB 45 recommend the frequency with which a public agency should have an actuarial study done?

MS. CZERKAWSKI: Yes, it does. In fact, it sets some requirements for that, just as the pension standards did.

The board requires actuarial valuations or measurements to be done for OPEB plans at a minimum of every two years for the largest plans, and a minimum of every three years for smaller plans. And that's based on size of plan membership.

There is, in addition to the requirement for measurements -- most plans will be required to have an actuarial valuation.

For the very, very smallest of plans -- those are fewer than 100 plan members -- the Board attempted to
try to provide some supportive alternative measurement methodology, I think is what it's finally been termed, that allows for the simplification of some methods and assumptions involved in the process of projection, discounting, and allocating those costs over periods, so that potentially those measurements could be made without the involvement of an actuary.

I would caution that if a government does choose to go this route, it does require some in-house expertise or an ability and willingness to sit down and learn a considerable amount about what things might need to be considered in terms of a measurement.

It also may incur some additional audit expense, because the audit community may not be able to rely on the work of a specialist in that case.

MR. LIPPS: And then as Mr. Low referenced, part of the panic sets in because we get these actuarial studies and they give us one big number, and that's the number that's reported in the note disclosure.

Is there anything that precludes an agency from, as part of the note disclosure, sort of showing the math behind where that -- in a simplified manner -- the math behind which that number is finally totaled up, so that it can be kind of compared on an ongoing basis with what actually then happens in a particular year?
MS. CZERKAWSKI: I'm not aware of any restrictions on what is presented. Governments certainly can include anything in note disclosures that they choose, as long as they do not contradict information prepared on a GAAP basis.

We set standards for minimum disclosure requirements, so any additional explanatory information, as long as your auditor agrees to sign off on that information and can attest to it, may be included.

There is additional information, again, in supplementary schedules about over time. In planned financial statements, there's also requirements to disclose comparisons of expense and amounts contributed, and a similar type of disclosure in employer statements. You can see over time, based -- comparing the actuarial calculations from a year-by-year perspective to what is actually being contributed. And we also require disclosures about funding policy, what's been done in accordance with the policy, a description of the benefits, a description of who has the authority, to make changes to those benefits, et cetera.

So there is a lot of information that's required. But any additional information that the government believes would be informative to the user of the statements, as long as it's not contradictory,
MR. LIPPS: And finally, Ms. Barzel and Mr. Young, how many years of data do you think you would need to have in order to develop reliable baseline measurements for purposes of comparability between similar types of agencies?

MS. BARZEL: I think I would start by saying, again, it's not just the number; it's how people are addressing the situation.

If the entire local government and state government community is in as much chaos three years from now as they are now, then we're still not going to be ready to compare anything. So it's not just the numbers; it's where people are in addressing the situation.

Having said that, I mean, a minimum standard is three to five years of information just to get a trend.

MR. LIPPS: So if you're going to use as a baseline, for example, the size of the debt compared to -- or that particular year's contradiction compared to, as a percentage of that year's revenues, you probably need, in order to develop some reliable comparability for comparison purposes, about three to five years?

MS. BARZEL: I would say that. A minimum of three years, certainly.

MR. YOUNG: I would agree to that.
CHAIR PARSKY:  Bob?

MR. WALTON:  Thank you.

One thing that I think needs somewhat clarification. When we talk about OPEB, the benefits -- and we use the term "benefits" quite a bit -- I think a lot of members, retirees, if you would, their concept of benefits is what the plan provisions are. And we're not really talking about the plan provisions, necessarily; it's the employer's obligation to pay for those benefits, which can vary dramatically from a percent, fully 100 percent, or to a flat dollar amount.

So inflation for the employer's cost is what that employer's history is, not necessarily that overall cost of health care. That's my understanding, at least.

But my question goes more from the standpoint of the difference between pensions and health benefits as it relates to OPEB.

In law, there's long-standing vested rights to a pension plan. You know exactly what it's going to be within certain parameters. In health, you don't have the same laws and history of court cases that document what a person's vested right is. And, unfortunately, we see many employers trying to address OPEB by simply changing the plan provisions, by dramatically increasing co-pays or the share that the retiree pays.
Did GASB consider the difference in the state of the law as it relates to vested rights for OPEB benefits as it did to retiree benefits, retirement benefits?

MS. CZERKAWSKI: Yes, it did. In fact, it spent a considerable amount of time talking about whether these standards should be based on essentially what is a legal liability as opposed to what perhaps might be viewed as an accounting liability.

The board chose to focus on the substance of the arrangement that the employer is providing; and by its actions, presumably is intending to continue to provide.

The fact that laws exist -- and these exist just about everywhere -- that says that retiree health-care benefits can be changed.

The board took that very seriously. And as I said, it did spend a considerable amount of time on that. But when it came right down to it, the board really believed that what's important here is to be reporting on the substance of the transaction that is and has been occurring.

If changes are made to the terms of what we've deemed the "substantive plan," which is kind of the term that we've used -- and we've borrowed that from our
friends at the FASB -- but if changes are made that alter
the terms of this arrangement, then certainly those are
going to be, and should be reflected in the measurements
that go into the actuarial valuation process and flow
through the financial statements.

So if, for example, a government decides to
curtail the benefits that are provided in some way, that
will be reflected; and, in fact, the standards require a
new actuarial valuation be performed if a significant
change has occurred.

So the accounting and financial reporting is
attempting to, in the most transparent way, represent the
transactions that the government has entered into. And,
again, we view it as an exchange. These employees have
been, are rendering services with the understanding that
there is something being provided as compensation for
those services. And that really underlies the board's
entire approach in this area.

MR. YOUNG: And that's an important distinction
from the standpoint of credit also, and the jurisdictions
that OPEB obligations are tantamount to pension and have
constitutional protection. They're rock-solid and cannot
be changed. And in other jurisdictions where they can be
altered, it's going to have a tremendous effect on those
two governments.
CHAIR PARSKY: Yes, for sure.

Paul?

MR. CAPPELELLI: Thank you.

First of all, I wanted to echo what has been said, which is this has been extremely informative having you come here today, and we appreciate your time.

My question is -- I just want to make sure I understand correctly. I think we’ve had a sense of impending doom that effective June 1st, 2008, all of a sudden now everything is going to come to a grinding halt. And I think what I've heard here today, if I've heard you correctly, is that as long as agencies and entities are either meeting the requirements of GASB and have their funding levels in order and there is no unfunded liabilities that are concerning to you, or if they're doing something proactively to try to remedy the situation that's acceptable, then, therefore, it's not likely that we're going to have this immediate adverse effect on their credit rating.

I understand there's other factors involved; but would that be correct to say?

MS. BARZEL: Yes, as long as people understand their situation and they are taking steps to deal with it; and as long as what they are doing is consistent -- and this is a very difficult thing to say -- but as long
as it's consistent with what other others in the community are doing as well, because, again, all these ratings are relative.

MR. CAPPITELLI: The other question I have is, how does California contrast with the rest of the country? I mean, are you in great demand to travel all across the country and make appearances as you're doing here today to clarify, or is California one of those that's a little different? I'm just curious.

MR. YOUNG: You're not alone.

MR. CAPPITELLI: Thank you.

CHAIR PARSKY: I think I would emphasize, though, the point that you made about you look at that entities are taking steps to deal with what they recognize are the issues. So I think it is accurate to say that "impending doom" is not the right way to characterize things. On the other hand, being complacent is not, either.

MR. CAPPITELLI: That's correct.

CHAIR PARSKY: Do you agree?

MS. BARZEL: I completely agree.

MR. CAPPITELLI: That's what I mean, too.

CHAIR PARSKY: Okay, well, thank you all very much.

We'll turn to our next panel. We really
appreciate your time.

    Thank you very much.

MR. COTTINGHAM: I actually have one thing.

Impending doom would be one thing. I think Mr. Richman
and Mr. Moorlach would look at that -- would appraise
that differently.

But since you're traveling all over the United
States and you've created such mischief with GASB, have
you ever thought of going back and withdrawing it?

I had to ask.

MS. CZERKAWSKI: And must I answer?

CHAIR PARSKY: Thank you very much.

Okay, our next and final panel today, thanks to
the good graces of our other two panels that said they
would present at our next meeting, we're going to talk
about having an actuarial overview. And I hope people's
eyes don't glaze over with this because I think we have
some very interesting presenters.

First, John, you're going to go first; right?
Or no?

Okay, Paul, why don't you introduce yourself;
and then we're going to divide this up into an actuarial
overview relating to pensions, and then an overview
relating to health benefits.

MR. ANGEL0: Thank you, Mr. Chairman.
Good afternoon, Members of the Commission.

My name is Paul Angelo. I'm a consulting actuary with The Segal Company in our San Francisco office. And it's always a good idea at the end of the long day in a warm room to have a bunch of actuaries to talk to. So we're taking that opportunity.

CHAIR PARSKY: That's just the way we planned it.

MR. ANGELO: I know. That's good.

Our office is in San Francisco, so we really do focus primarily on the pension side. We do OPEB valuations as well, and I work with our colleagues here in the arena.

My comments will start with an overview on some of the funding concepts that apply to both OPEB and pensions; and then I will continue on to talk more about some of the history of public pensions in California and how they reacted to the events at the turn of the century.

Our experience is based on, we are the valuation actuary for eight of the larger county systems: Orange, San Bernardino, Ventura, Contra Costa, and several others. We're also the actuary for three of the large city systems, and we're the actuary for the University of California.
We've been doing this since about 2002, which I can tell you was an interesting time to get into the pension consulting business. Like I say, anybody can do this stuff in an up market. But we showed up really in the era of when the actuaries really became the Bad News Bears, and worked with the systems in terms of dealing with the progression of costs early in this century.

Now, I apologize a little bit, the outline that is in your book is a little more detailed and is impossible to read because they put three slides on one page. So what I'm working from here, what I just passed around, it's the same page numbers as what you have in the book, and also it is on the Commission's Web site. But there's a little more detail in the one that's on the Web site than the one that you have before you.

So we're going to talk a little bit about how you fund retiree benefits. And there's a little terminology and a little bit how the numbers behave. And this will apply both to OPEB and to pension, and then a little bit about the environment that public pensions are in. Some of this you've already talked about today, DB/DC and a little bit on financial economics, a little survey of what -- how public plans, pension plans are laid out in California.

And then what I really think would be the most
useful history and data for the Commission to consider is, you know, for pensions in particular, how we got where we are today.

There were comments made at your first meeting that the pension situation and the OPEB situation are different, in that OPEB, you're kind of figuring it out from scratch. Whereas pensions, there's a lot of information that's already there. So what I'm hoping to do today is really, on a factual basis, go through some of that history.

Now, the one thing, if you're funding a retiree benefit, when you get to the actuarial part -- and this is really the first conversation you've had today that gets technical about where these numbers come from -- there's assumptions, and you've talked already about funding methods, and amortization periods and all those things, but you should write on the back of your hand what we tell our trustees to do, which is that $C + I = B + E$, which is that ultimately, contributions and investment income provide benefit payments and expenses. That seems awfully simplistic, but you'll find in a lot of situations pulling back to that level of clarity will be helpful.

The assumptions and the methods that we talked about are timing issues and budgeting issues, but
ultimately, you've got to actually earn the money or make the contributions.

Now, the terminology that you'll hear, you've heard the term "ARC" already. Well, ARC is already a composite number. And it is made of two things, and one is called the normal cost and one is called the amortization of the actuarial unfunded liability, which is a lot to say quickly.

The real focus, especially on the pension side, is on the normal cost. That is, if you want to know what each year of service costs as an add-on to the rest of the benefit package, we would urge you to start and end, really, with the normal cost.

One thing about the normal cost is that it is independent of your funded level. Assets high, assets low. The normal cost is -- for the Neil Young fans, it's like "Rust Never Sleeps." This is sort of -- it accrues, and it accrues with service, and it is designed so that if you fund it, if you contributed to normal cost every year during the years of active service for the employee, at retirement, you would have enough money on a present-value basis to fund that person's benefit. But it is a budgeting tool.

Now, this accrued liability number, counter-intuitively, it is not the amount that the
members earned. It is actually not connected to how much
the member would get if they quit or how much you would
pay if you shut the plan down today. This is a little
known fact. It is really a budgeting tool. And what it
says is, if you had paid the normal cost every year in
the past, and if today's facts had always been true, what
would you have in the plan? So that's kind of your "as
if" asset number. You compare that to the real assets,
and that gives you the infamous unfunded actuarial
accrued liability, assuming that the assets are less than
that liability, and you have an unfunded liability.

Now, the other way, though, if you had a
pension plan at the turn of the century, as you've heard
said by many of the Commissioners and other speakers, you
actually had a surplus. So you have a situation where
the assets were greater than what you would have simply
accumulated if all the assumptions were true. And so
that gives you a surplus.

Now, the way that these work in contributions
is pretty straightforward. If you have an unfunded
liability, it means that just paying the normal cost is
not enough. And the unfunded liability tells you how
much you're short on a value-today basis.

It goes the other way. If you have a surplus,
it means that over time, if you pay the normal costs
forever, you end up with too much money, so you actually are ahead of your funding game.

And this is where the amortization period, which I'm going to harp on quite a bit in the latter part of this talk, the amortization period becomes crucial, and there's an inverse relationship here. If you have an unfunded liability -- I think you've probably got your hands on this one -- the longer period you take to amortize it, the lower your current costs will be; but the longer you're going to have to live with that unfunded -- and this is where people talk about intergenerational transfers and putting burdens on our grandchildren, those kinds of things.

If you have a surplus -- and we had surpluses in this state in the turn of the century -- it goes the other way. The shorter your amortization period, the lower your costs are, because you're basically taking that good news, that unexpected good news and you're taking credit for it faster. So you really -- you know, when you're in an unfunded position longer, you know, it tends to raise alarm bells.

Well, maybe what we didn't know at the turn of the century was that if you are in a surplus position shorter, it raises the alarm bells.

Now, I also want to make it very clear, this is
20/20 hindsight. We're not saying that all these things didn't make sense at the time. But we are saying that with the benefit of the experience that we have, especially on the pension side, we need to keep an eye on surpluses as much as we do on unfunded.

There's an irony here. If our OPEB benefits -- and I'll say this to my colleagues, and I'm sure they'll agree -- if our OPEB benefits were as well funded as our pension benefits, we'd be having very different conversations today.

So you may be tempted to say, "What's the deal with pensions? They're 80, 90 percent funded. Why can't we just talk about OPEB?"

Well, I think that there is a lot of information, as we see on the slide here, for pension plans, you know, you really -- let me start again.

Pension versus OPEB gives you an idea to see the two opposite ends of the funding spectrum. Where you are with OPEB right now is where you are when you're just getting going, and that certainly raises a lot of hard issues.

As it turns out, when you get to the other end of the spectrum, when you get to where a plan is fully funded, your assets and liabilities are equal, and all you have to pay is the normal cost; you know, you still
have policy issues. And I think a review of the history at the turn of the century will show you what those are.

So as challenging as underfunding is -- and that is really your great burden as a commission -- at the policy level, overfunding also raises policy issues that we would want to bring to your attention.

So, now, I'm going to be real fast DB/DC. You've heard a lot about DB/DC here.

The actuary perspective is one I think does not necessarily show up in every conversation. Go back to C + I = B + E. And basically, in a defined contribution plan, "I" is lower and "E" is higher. And so you're either going to have more "C" or less "B." You can do the math there.

Now, you can have a debate on the "I," whether, in fact, individuals can earn as much as an institutional investor. There's a recent survey that shows that the individual accounts are earning an average of 1 percent less. I was surprised it was only 1 percent. But you can look for data on that. Just this month, I saw something that shows that money market accounts earn less than institutional pension money because of the expense side. They're agency costs that increase the "E." So we can have a debate, I suppose, on whether DB plans or DC plans earn more during the accumulation period, that
is, while people are in their active years of service.

Where there is no debate is at retirement. Because in a defined contribution plan, the only way that the member get out of the risk game -- that is, get out of the investment volatility risk, and most especially, the longevity risk is to buy an annuity. If you buy an annuity, you are moving into bonds. And so you have reduced your capital "I" from 8 percent to 5 percent.

So the principal advantage that a defined benefit plan offers is that you can continue to earn a balanced portfolio, 60/40 kind of mix, during the retirement pay-out because, after all, the plan is not retiring, only the member is retiring.

And I do not know any way to recreate that sort of economic advantage in the defined contribution plan.

I also resent the term -- you'll hear -- in fact, if you read the Richman proposal that was from a couple years ago, the Richman/Jarvis proposal, it talked about comparing a DB pension plan and a DC pension plan. There is no such thing as a DC pension plan. It's an oxymoron. Because a pension is a series of payments. It is not an account balance, not an individual account.

And so until you deal with the annuitization risk, you're not really talking about benefit security.

And as I say at the top of this slide, our task
here, if I had to summarize it in a sentence, is to convert taxpayer dollars into retirement security for the people who spend their lives in service to the taxpayers. And on this analysis, a pension plan is simply a more efficient economic engine for converting those taxpayer dollars into true retirement security, which means an income that lasts as long as you live. So that's the sermon.

Another thing that you will hear as you talk about measuring liabilities -- I hope you don't, but it may come up -- is financial economics. There is a move within the actuarial community, it started about 2003, it was called the "Great Controversy." Imagine actuaries having great controversy. And it was, are we fundamentally mismeasuring our liabilities? You know, should we be using basically bond rates, should we be measuring our pension liabilities as though they were bonds? And the argument is, they are a stream of payments. A bond is a stream of payments. They have something called a law of one price, which says if there are two streams of payments, they should have the same price. And so the idea that by taking on more risk in your investments, you lower your liability, which is what happens when you invest in equities. They say that this doesn't make financial statements.
Well, I think that's perfectly true if you are talking about a corporate plan. Because a corporate plan ultimately can be terminated, and you can be forced to go to the market. Whereas a public-sector plan, they simply don't terminate. There is no market out there for buying and selling the liability of a public-sector plan. Whereas there is a very defined market for doing so in a corporate plan.

So if that comes up -- I can save you some time. The question is should public plans measure their liabilities according to financial economics? The answer is no.

Now, that's our brief summary of sort of the two environmental factors.

In Grant Boyken's summaries that he put together, he has sort of an overview of public plans in California. I won't go through too much detail. CalPERS is dominant in a number of ways -- first of all, it is the mandated retirement system for the state employees. It is very much a policy leader in terms of pension practice because of the agencies. That is, any number of individual local employers basically get their pension benefits from a menu that's provided by CalPERS.

Then come the county systems. This is very distinctive to California. You have this group of
20 counties. It's 20 -- it's actually 14 of the 17 largest counties. It's most of the large counties which are independent systems operated under a common legal framework. And these are the so-called 1937 Act or 1937 CERL counties.

There are two independent counties, San Francisco and San Luis Obispo. All the other counties are CalPERS agencies.

There's a table here that has them all listed.

And then you have, as in Grant's write-up, there's about 32 or 33 independent city systems. The largest ones are the three LA plans. And the LA plans are actually as large as any of the counties, except Los Angeles County. So the LA city plans are, generally, the same size, more or less, as Orange and San Diego, the very largest of the non-LA County plans.

Another interesting comparison is -- you have CalSTRS is the other independent system, 140 billion, and then the University of California, which coincidentally is about the same size as LA County. They're both about $40 billion in assets, both about 120,000 active members.

So when you talk about statewide solutions, there's a lot of discussion here about local control, you have a fairly complicated mix of plans; but it's not just like in a lot of states where there's a big state plan
and a lot of independents. This county structure adds an additional layer of systems that are comparable but nonetheless independent.

The last thing I'll mention here gets to really something that the auditor -- that the GASB folks were touching on, and the bond underwriters were talking about, and that is, in a lot of states, whoever it is that comes up with the retirement contribution sends the bill to who is going to pay it, and maybe it gets paid or maybe it doesn't. Or maybe the same group that has to come up with the money sets the contributions. There are states where the pension, state pension systems are run by a committee of the state legislature. Think about that for a second.

Well, what you have in California dating back to 1992 is a governance structure that I believe is a model for the nation. Now, we can talk about whether it always works and everything else, and is it overreaching; but the idea that you have independent boards -- and, of course, counties, most of our experience, you have independent boards that come up with a contribution requirement, and they send the bill over to the employer, and the employer has one choice, and that is, it will pay that bill.

Well, this pretty much puts aside a lot of the
issues that I think affect the bond underwriters, because
there really is -- and I think what they said was, if
you have a system where it's clear that the contribution
will be paid, well, that's exactly what you have in
California, and it really goes back to Prop. 162, the

So that's sort of our overview.

And, Mr. Chairman, you will caution me when I
get to time, I trust?

CHAIR PARSKY: I'm cautioning you.

MR. ANGELO: Okay, thank you. That's why I
asked. Thank you.

Okay, well, what I'm talking about is what
happened at the turn of the century. The market spike --
you know, if you wanted to mess with the pension system,
the worst thing you can do is not to have the assets go
down. If you want to really mess with it, what you do is
have the assets go up first and then go down. And that
is what happened.

And as it happened, this was at a time when
because planners were well-funded, partly because of
pension obligation bonds which for the counties started
around the mid-nineties, there was some actuarial
arrogance going on, in that we thought that, you know, we
can manage this volatility. And so what we had was very
short amortization periods. We figured -- and this is also part of the federal tax law in 1987 for corporations. It was shorted for gains and losses, from 15 years to a five years. So we thought this is just going to be wiggle; right? A little bit of wiggle. We get it paid for in five years. What we didn't anticipate is that it was going to wiggle up. And so what happened was you got in a situation where you could have a relatively small surplus. And instead of gradually reducing your contribution, it would knock it to zero. And, again, ignoring compound interest, if you have a surplus equal to five times your normal cost, which was very typical, and you have a five-year amortization period, that means you're going to contribute zero for five years.

Now, there's a term that we have used for the surplus, which is probably not correct but we call it "actuarial heroin," only because it's something that you kind of get used to and then it goes away, and then you've got to sell the TV.

There's a certain amount of that that happened here because --

CHAIR PARSKY: Do you have a TV show?

MR. ANGELO: I do not. I do not.

I debated whether to -- well, it turns out to be a
fairly --

CHAIR PARSKY: I'm giving you a warning, sir.

MR. ANGELO: Yes.

All right, so because of the very short amortization periods, what we had was, we had contribution holidays, which had two impacts.

The first was that the employers, in doing their budgets, got used to having a zero as the line item for pension expense; and the other was that it raised issues of fairness.

There's a source document, which you can go back to, it's the Public Retirement Journal, July of 1999. And that's a key date, because you remember, they didn't know what was coming. This describes the environment. And CalPERS was a leader in this discussion. And the idea was because the surpluses are only providing contribution reductions for the employers, how do we share the good news with the employees? This led to the development of the new benefit levels, which were mandatory for state agencies and were optional for local agencies within CalPERS; and then there's also a "me, too," effect, that is within the counties and the other local governments that would do it, as well.

Two other CalPERS policies which were crucial here, and that is, in an effort to encourage adoption of
the new benefits, they took action with regard to the actuarial value of the assets. Now, we're not going to go into that here, clearly. But what they said was, "We will increase your asset value that you get to count in doing your contribution calculation only if you adopt a new benefit." So they basically made gains which were deferred from this smoothing period, if you know about smoothing, they took some of those gains and said that they would accelerate recognition of the gains to help you cover the cost of the new benefits.

That was first done in 1999, and it basically moved up to 95 percent of market. That would have been, you know, one level of policy.

The interesting one is -- and now I go to another issue of the Public Retirement Journal in May of 2001 -- now the original policy had expired, but the momentum for benefits was still there. The market had now turned. Remember, the first down year was 2000. The market started to turn. The actuarial value was already bigger than market, and CalPERS adopted a policy -- now, at this point was not mandatory, but it was an option to the local agency -- that they would actually move your actuarial value from 105 percent of market, to 110 percent of market, in round numbers, if you adopted a new benefit formula.
So there clearly was a belief that these surpluses were part of the environment and were a legitimate source for funding the new benefits. This has its impact on the collective bargaining environment.

I will jump to our current state, which is with the benefit of hindsight, CalPERS in 2005 did an exhaustive review of funding policies. And these, I would very much call to your attention as the sort of things that we've learned of what you do, you know, now that you know what the effective surplus can be. They went the opposite of what you'll hear all the corporate folks talking about. Instead of marking to market, they actually moved away from market. So instead of three-year smoothing, 15-year smoothing. What ever that means, it's more smoothing.

What this would have done at the turn of the century would be to stretch out those gains further.

The key here is surplus. If CalPERS ever again finds itself in a surplus position, instead of taking credit for that in contributions over five years, they would mandatorily stretch it over 30 years, which basically dilutes the surplus severely.

So these I think would be funding policy considerations that you could take into account, and then
there were things here about benefit adoption procedures, the question about whether to do a popular vote or not. You will get different information. You have some jurisdictions where even though there was a popular vote, they did adopt new benefits. Some, where even though there was no requirement for popular vote, they didn't adopt the new benefit. So it's not really controlling.

And then the last thing would be on future benefit levels, you know, I understand that there is sort of an issue of mandate here, and that is, are we focusing on liability, are we looking at redesign?

I would give only one proposed consideration for you. There's a lot of talk about coming up with a new plan design that would apply to everybody. Well, we are in the plan-design business, and I do not pretend to come up with a single plan design that would fit all the counties and all the jurisdictions and all the agencies.

If you find yourself -- and this is a big if -- if you find yourself in the situation of looking at new benefit designs for new hires, you might consider going to each local jurisdiction; and instead of imposing a new formula, look at their history of formulas and perhaps just dial it back. I know it's not a pleasant consideration; but if you are looking at a lower benefit,
what do you do about the jurisdiction that never raised
benefits? Why should they even have a new benefit
imposed on them?

So one way to do this would be to look at the
history at the local jurisdiction and craft your solution
to take their actual historical actions into account.

Thank you.

CHAIR PARSKY: Thank you.

Paul thought that we should ask him questions
first because we would forget about what he said.

Given his sense of humor, I don't think that
will be the case.

MR. BARTEL: So just to be clear, I'm not going
to forget what Paul has said.

CHAIR PARSKY: So let's finish our panel
discussion and then we'll come back and ask questions.

MR. BARTEL: One of the things that's
interesting, just to be clear, you all know this, I'm
sure you know in some life another actuary, I have no
great sayings, like "actuarial heroin," so those of you
who need a nap will probably be able to take it now.

I'm John Bartel. I am president of a very
small actuarial consulting firm, Bartel Associates. We
have 15 employees. We represent a bit of a different
market than the Segal Company.
We do a fair amount of actuarial work. 95, 98 percent of our work is really for California public sector entities. The majority of those are special district cities, counties. Over half of our work is related to GASB 45.

So I have a relatively short presentation. But one of the things I was fascinated by, were the questions of the prior panel. And with your permission, I'd like to maybe try to answer a couple of those questions rather than getting into my presentation.

Would that be okay?

CHAIR PARSKY: That's fine.

DR. GHILARUCCI: Please.

MR. BARTEL: You asked a lot of great questions, but I wrote down five that I thought were particularly interesting and probably should be discussed -- I'm not sure what my fellow panelists will say on this.

One of the very first questions you asked: Should you have a standardized set of actuarial methods and assumptions?

So the short answer is: No.

The long answer is: Would you really want to have a standardized practice of medical procedures for somebody who is coming in for a diagnosis? And the
answer is: Perhaps, depending upon what they're coming in with; right?

But when you look at some of the numbers I'm going to show you in a couple of minutes here, you're going to see that the level of promise, the nature of benefit from one agency to the next is gigantic. It's unbelievably different from one agency to the next.

For you all to be able to come up with a standardized set of methods and assumptions, I will suggest to you will be virtually impossible.

Let me give you a slightly left-turn recommendation, and that recommendation is rather than having a standardized set of assumptions, why not establish a panel, populated at least in part with actuaries who can review assumptions and methods for reports that are prepared for California public agencies?

Now, I hate to suggest another level of bureaucracy, but at least then what you do is you put people who are qualified to make the opinion in the line of fire. And, frankly, that's where we, as actuaries, really ought to be.

One of the things that actuaries have done a horrible job at, just a brutally bad job at, and that is explaining how rigorous we are and how good we are at our job. And the reason we're horrible at that is
because we don't become actuaries to stand up here and talk to you all. We become actuaries because we like numbers. We like sitting behind computers doing calculations, and that's really what most of us do.

So you don't very often hear actuaries standing up and kind of defending themselves; but what you would hear me say is, I think you would be making a big mistake if you come up with standardized methods and assumptions.

So that's question number one.

Question number two is the funding method -- there was a comment, I want to say it was Parry Young who said that the majority of retirement systems around the country used entry-age normal. That has not always been the case. Most have moved to entry-age normal for really very good reason, and that is, it generates cost contributions as a level percentage of pay, which works really well in the public sector budgeting model, if you will.

And so I think most retiree health-care systems, when they look at that, will move to an entry-age normal funding method. That's part one to that.

There are, in fact, other actuarial funding methods which will generate lower, in some cases, higher numbers.
So you can, in fact, if you play with the funding method, you can, in fact, change the numbers.

But I think you will see if employers understand what the actuary is saying, most will move to that entry-age normal.

There was a couple of comments or questions on the discount rate. What you would hear -- and the impression that I had was that there might be some skepticism or some concern that an agency might select a discount rate that would -- perhaps might show the liability is maybe lower than it should be.

What you would hear me say is, that ain't going to happen with any of my clients, and it ain't going to happen with any actuary who is really meeting actuarial standards of practice, period.

Does that then mean that all agencies should be using the same discount rate? No, it does not. If you think for a moment, we have clients who I suspect will probably continue some sort of level of pay-as-you-go. And when we look at the underlying rate of return of their general fund, we do, in fact, see quite different levels of rates of return of history; and that's really what the actuary needs to be looking at, is what rate of return has the agency earned, and what might they earn in the future?
Now, there is some judgment there. But the review of the outside auditors, the review of the bond-rating agencies, I think, will really mitigate any fluctuation that you might see or any interest in fluctuation.

So -- and I feel -- if you can kind of tell from my tone of voice, I feel pretty strongly about that, that if the actuary is really doing the job, then, frankly, you should not be worrying about the numbers; you should be worrying about how you deal with the numbers. And so that's question number three.

Number four was a question that, frankly, I thought was really an interesting question, and that was, in the footnote, does GASB require any explanation for the change in liability from one year to the next? Well, the answer to that was very simply no. But, really, the question is, should they. What you will hear me say is one of the challenges -- the single-most difficult thing in presenting an actuarial valuation, particularly one for an agency where this is a second valuation, is why did the numbers change from the prior year to the current year? Volatility, we just went through huge amounts of volatility in pension contribution rates. You ain't seen nothing. The volatility of the health-care rates from one year to the next is just huge.
Does that mean that the numbers are unreliable?
No. It means that the number was the best guess at the
time; and the actuary's job is to explain why it went
from point A to point B. So that explanation in
understanding why the numbers are moving, I frankly think
is extremely important.

So what I wanted to do is just very, very
quickly go over a couple of things that I thought you all
might be interested in. Rather interesting to me, one of
the very first questions I got early on when we were
doing -- what I'll call GASB 45-compliant valuations
were, "Man, our numbers are big. How do we compare with
everybody else?" So one of the questions I really
struggled with is part of your charge. How do you really
do that comparison? How do you understand the magnitude
of the numbers?

(Mr. Pringle left the hearing room for the
day.)

MR. BARTEL: And early on, we considered that
maybe we would go out and do a survey.

But, frankly, the more clients I talked with,
the more I really recognized that they all use different
terminology to mean the same thing, or -- thank you very
much -- the same terminology to mean something else.

And so English ended up getting in the way of
doing that sort of a survey. And benefits are hugely
different, the health-care plan options in retirement are
hugely different.

Within an agency, if you go out and do a
survey, you might have provisions for one or two
different benefit structures. We had agencies that have
12 different benefit structures for one agency,
12 different bargaining groups.

And so getting a response, a reasonable
response in a survey, brutally difficult.

And then you have the added complexity that
typically, not always -- typically, the person who
completes the survey is not the person who knows the
answer.

So, really, there's no -- what I'd like to do,
I'm going to skip over for a moment slide 4.

I'm only going to skip over that for a matter
of time. I would kind of encourage you, that's actually
an approach to dealing with the issue that we think a
fair number of agencies in California are going to adopt.

What I thought I would do, though, is go
through a series of graphs.

CHAIR PARSKY: I wouldn't say a series of
graphs, because we want to make sure we complete this
program.
MR. BARTEL: Fair enough.

Trying to answer that first question, how do our numbers compare with other agency's numbers, what we tried to do was to take the actuarial information and express it as a percentage of payroll, really under the theory that most public agencies have a revenue stream tied to payroll. And, frankly, we don't know what an agent's revenue stream is. We do know what the payroll is because we ask for it.

So you'll see the next two slides. And I'm just going to tell you very quickly what's here rather than looking at the detail.

But slide 6, what we show here is the actuarial-accrued liability for miscellaneous or general non-safety, compared to safety. And these are as a percentage of what I'll call for a moment a pensionable wages or PERS-able wages. And what you see is, our client with the lowest actuarial liability as a percentage of payroll was at 11 percent, and the highest for miscellaneous was approaching 400 percent. And the variance in those is huge.

And then if you take a look at slide 7, slide 7 shows the normal cost, Paul did a great job of explaining what normal cost and annual required contribution are. But you see those numbers.
And then rather interesting, too, is pay-as-you-go current as a percentage of payroll, and pay-as-you-go 10 years from today as a percentage of payroll.

So arguably, this is why we're talking about this. We're talking about, will an agency have a budget issue ten years from today or 20 years from today due to retiree health care? So that's -- now, let me just tell you what the database is here.

We have done about 130 studies. That is a very small number when you look at the agencies around the state.

So you would not hear me say this is necessarily a representative cross-section. These numbers, however, do seem to be consistent with other studies we've seen.

I'm going to skip for a moment to slide 13. We kind of saw this graph. Parry Young put it up. This happens to be an actual graph for one of our clients. The blue line is the pay-as-you-go line over the next 30 years, prepared on what the actuaries will understand to be an open group projection, meaning, we took into account future hires, and the 20- and 30-year amortization of the ARC. And, frankly, this is what makes prefunding -- this graph is what makes prefunding
what we're really saying here is, over the next 30 years, thank you very much, you will be paying a lot more than if you keep going on a pay-as-you-go basis. So this is a typical graph that you see. Let me just show you the next graph. And this is the cousin, if you will, to that first graph. And this graph says if you do pay as you go, here is what your unfunded liability is going to be in 30 years. And if you do, like, 20- or 30-year amortization -- and my little caveat if all assumptions are met -- here is what your unfunded liability is going to be in 20 or 30 years. So what you're really getting for that extra payment of cash is taking care of your unfunded liability.

Now, that's easy for the actuary to say; right? Very difficult for the elected officials to execute.

So I decided -- this is not a scientific test. If you had asked -- what I decided I would do was go back and think about my clients and make my best guess as to whether I think they will prefund or not; and if so, at what level? In fact, at what level? One of the things that's fascinating to me is probably four years ago, I wrote down a little figure, and I said, "I think less than 20 percent of public
agencies will prefund at any level."

I am convinced I was wrong about that. What I really misunderstood were a couple of things. One is how seriously clients are taking these numbers, and how seriously I think the public officials are taking these numbers. So it's really a combination of those.

So paying the full ARC, I think that's going to be a very small percentage. I think that 10 percent is probably high.

And so some sort of a phase-in to the annual required contribution. I actually think most agencies will take that approach.

Consider a target funding level. In other words, really saying, should we be 100 percent funded in 20 or 30 years? Maybe what we ought to do is have a lower target level, and maybe that's a better use of public funds. We think that's a challenging thing for agencies to do and approach for them to take. We think, however, some will take that approach.

Unknown, because I'm an actuary, I left myself an awful lot of wiggle room, and I have now moved from 80 percent, down to 20 percent in terms of "Continue pay-as-you-go."

Now, again, in the interest of full disclosure, our client base is cities, counties, special districts.
We do not do much work for school districts.

I was particularly interested in the comments of the gentleman from the school district earlier. And I would probably encourage you to listen very hard to what he had to say, because I think the funding mechanism -- their approach to this will be significantly different than most other agencies. Our clients versus school districts.

So this is likely not representative, but it's kind of my best guess.

One of the things we've really spent very little time on --

CHAIR PARSKY: This is going to be your last slide.

MR. BARTEL: Fair enough.

One of the things we spent very little time on, really, was the uncertainty associated with the legal issue. We've read several legal opinions as to whether or not OPEB are or are not vested. The attorneys seem to say no. But frankly, our clients aren't entirely convinced that they agree with that. So they believe there is a fair amount of uncertainty associated with that issue.

I think the majority of agencies, when it comes to plan changes, will make very few or little changes;
but I think the majority will bring these numbers into the bargaining process. The numbers are almost too big to do anything else.

CHAIR PARSKY: Thank you.

Leslie?

MS. THOMPSON: Yes. Thank you, Mr. Chairman.

At this point, my slides are now obsolete and redundant, so I'm just going to wrap up with a few comments that lead us now into a discussion of the larger framework of solutions. Not getting into the specifics of solutions. But I want to talk with you about what I'm seeing my clients do in terms of trying to get their arms around this problem in an, I want to say efficient -- I don't know if you can get your arms around it efficiently, but in an effective manner.

There's three things that I have seen emerge in the discussions that are coming from all of our employees.

Number one is, above and beyond any other concern, they want to be able to have access to medical care. And it's coming out in the form of, "Please don't cut me out completely. Let me have access." This is important because in some cases, the only benefit available is an access-only benefit, but the benefit is the blended rate or the implicit subsidy. That is, they
get a lower premium cost because they have been blended with the active employees.

Individual affordability then seems to be next on the list. "Please make it affordable for me." And that needs to be balanced then with sustainability and predictability.

And I think one of the things that GASB has done is it's helped us to see whether or not a benefit is sustainable. And I mean that because I work with, for example, a fire district that might only have three retirees, so it's affordable today. But when you do the GASB calculation and convert everything into a level dollar, you can see it truly isn't sustainable. And it seems that the objective of all of our employers is to have a benefit that is both affordable and then sustainable.

So I see those as the three overarching issues that we're looking at, and that this tension of allocating resources, not only between these three issues, but allocating resources between all of our programs has become a very bright-lined issue for all of us.

There are three main approaches that I'm seeing to attacking this GASB issue.

First is the management of claim costs. That
is the management within the underlying health-care plan. That's been going on for a long time. Nothing new to any of us. That's deductible, converting from co-pays, to coinsurance, out-of-pocket, all that stuff that's going on. That still needs to go on, just likes the WEFIT that was talked about earlier today, putting in wellness incentives. We have to manage our claim costs.

Second is the OPEB benefits themselves. The management of those. And you've heard a number of tactics today, whether it's tiering for new hires, whatever it is. The way that I'm seeing that framed is through looking at our generational contracts. What do we owe retirees, what do we owe current actives, and what do we owe new hires?

It is clear from the statement of this commission, that we are settled on what our retirees and actives in terms of meetings promises already made. But new hires, I'm seeing the questions getting raised around what do we owe them, and how do we remain competitive in our marketplace, and what is going on competitively with our new hires, and is it fundamentally different than the retirees that we now have today?

And then finally on funding, I think the core issue around funding is to optimize our resources without having an adverse overall effect. The reason I say that
is, you could do something in GASB OPEB but then affect your bond rating so the total cost -- you know, your cost of capital goes up, and then you've impacted your entity, you haven't gained anything economically. So that's why you've got to work there between what you do with OPEB, right, and the cost of capital. So that's why -- but once you -- you need to settle on benefits first so you know what you're funding and you know what your commitment is. And then you can move to the funding question of: Do we put it in a trust or not?

And the fears around irrevocable trusts seem to center on, "Once I put the money in, is it really going to be needed or am I going to not need it? I mean, I have to know if the benefits are going to be there or not."

So there are risks and rewards to funding as well.

That's the highlight, that's the framework for solutions.

Thank you, Mr. Chairman.

CHAIR PARSKY: Thank you very much.

Questions?

Yes?

MR. CAPPITELLI: Yes, I have a question.

Earlier today, we had some presentations where there
was some inference that somehow -- and I think it was centered around the notion that if you need to fund the deficit or fund the unfunded liability, you need to look for some method. But if I heard all of you speak today, one thing that came through to me is that the calculations such as 3 percent at 50, those are based on actuarial calculations and based on an understanding of how much is going to be in the system, et cetera.

If you're going to start altering those formulas, what you're doing, in essence, is you're probably providing additional money or funding to be able to put towards something else, unless you really have miscalculated your actuarials. Would that --

MR. ANGELO: Speaking to the pension issue, you know, you get to the question of is there a pension crisis in California? I don't think we have a clear answer to that yet.

I will tell you that as we present actuarial reports, as we have done so for the last -- you know, ever since 2002, you know, we have shocked a lot of employers. And so what we hear at the meetings -- and this is just tales from the road -- is that the level of pension costs -- and I'm not speaking about the state employer, because that's not where I work -- but the level of costs, including the costs of the benefits that
were adopted at the turn of the century, are at least, in the words of the employers, putting a burden on those employers, and causing them to cut services. I mean, this is what we hear over and over.

So the idea that by lowering the benefit that this would somehow free up resources, that is not the message I'm hearing from the employers. What it would do is allow them to return to a more manageable level of costs. That's the message that we hear from the employers.

MS. THOMPSON: And don't forget that one of the things brought up earlier today was to use a tax-advantaged approach. Money out of a 401(a), the pension plan, is not tax-advantaged, where out of the retiree medical will be. That's another sourcing issue.

So not to contradict Paul, but --

MR. ANGELO: Yes, I was speaking, again, really just on the pension side. Again, it was sort of a parallel but related discussions, exactly. Exactly.

MR. LOW: I have two questions. You mentioned this blended rate issue. We've been hearing from some that you have to calculate the GASB unfunded liability for the retirees separately from the actives unless you have a plan that is community rated; is that true?

MS. THOMPSON: Yes.
MR. LOW: The second issue is, the cost of health care, the assumption on the cost of health care, I've been hearing, we've got these double-digit health-care rate increases, and they're saying this is going to kind of continue on into the unforeseen future, which they are saying this is a reality, which it seems to me that runs in conflict with the reality that if this does happen over this 30-year period, then your cost of health care is going to be about five times your mortgage.

So what is your sort of assumptions on health-care rate increases?

MS. THOMPSON: Well, all of us as actuaries, I believe John piped in, too, but most of us, we start with some double digits in earlier years, is it does trend down.

MR. LOW: To about what?

MS. THOMPSON: In our case, we generally trend down to 5. We'll go lower if you have some pretty significant cost containment features, and we'll recognize that. But it generally goes down to five for an ultimate rate. And now, I defer to John.

MR. BARTEL: Yes, we're very similar to that. Our ultimate rate typically is four and a half, not 5. We grade to that four and a half over about a 10-year
period.

Frankly, we could have a very long conversation because there are other actuaries who believe it will continue at a much higher rate for a longer period of time, and there are still other actuaries who believe that we're at a crisis today, and a 5 percent health-care trend for next year is appropriate.

So most don't fall into either of those two camps.

MR. ANGELO: And there's a pattern that's emerging there, which we try to discuss it with the clients. And if you compare it from year to year, say, our current assumption is 13 percent and it's going to grade down to 5 percent over 10 years, because eventually it has to go down, otherwise the entire economy turns into the medical sector.

But then we come along next year, and it just doesn't seem to have gone down yet. And so this 13, down to 5, next year it's not 12 down to 5, it's still 13 down to 5. So we kind of keep pushing this thing out, which means in effect, we're actually increasing the assumption each year. Because it's got to come down, but it just doesn't seem to be happening yet.

So there's a little bit of an incomparability from one year to the next, because the assumption looks
the same, but it's actually changing.

CHAIR PARSKY: Matt?

MR. BARGER: The question I had -- I have another little technical question that I was interested in here, which is the notion of actuarial value of assets. I mean, I can understand about an actuarial value of liabilities given all the uncertainties. I mean, the notion that you don't actually know how much your assets are worth strikes me as sort of improbable.

MR. ANGELO: No, it's not how much they are. This is part of your funding policy. This is a policy that you adopt.

If you remember how the cost is determined, there's that amortization piece. Well, the market value of pensions -- we're thinking of pensions now -- is quite volatile. When the market value goes up, your unfunded liability goes down, your cost goes down.

Rather than have your contribution vary widely from year to year, we don't run the calculation on the raw market value. We run the market value through a shock absorber, which in effect means we take whatever your gain or loss was each year; and instead of recognizing it right now, which is what the market value does, we spread it over five years -- typically five years. So the actuarial value of assets is a technique.
It's not that we don't know exactly what the market value is or we deliberately -- or, excuse me, our boards deliberately do not use the market value. They, instead, take a number that tracks market but dampens out the short-term volatility. That's what the actuarial value of assets is.

MR. BARGER: For year to year, though, in terms of what the value is?

MR. ANGELO: Actually, the report will show both numbers.

MR. BARTEL: Always?

MR. ANGELO: Always. But the ratio that gets published, if you ask me how well-funded am I, that generally is based on the actuarial value. Because again, the only -- this gets back to the fact that the plan is permanent. It's not going to be terminated.

The corporate plans, you almost have to look at market because if you shut down, you take the market value to market. Whereas if you can take that longer-term perspective, you don't really need to worry so much about the year-to-year volatility. And that's why the consistent, ongoing funding progress is measured on the smoothed value or actuarial value.

MR. BARTEL: In fact, if you think about this, it makes a certain amount of logic sense. Your market
really is only money in the bank if you sell those equities, if you sell. So it really isn't there until you sell those equities and you get the money in the bank.

So this smooth market is designed to do what didn't happen in the late nineties and the early 2000s. In other words, you saw the contribution rates drop and then you saw them shoot back up.

One of the side comments that I would make is CalPERS has gone to 15 years smoothing. They are out so far on an actuarial limb, it isn't even funny. But it is a great idea.

I'm not sure all actuaries will agree with me on that. I really think they have done the right thing on that particular issue. And the reason is, if you go back and look at the market rate of return and use their current methodology, what you will see is contribution rates would have been relatively stable if they had been using this methodology for the last 15 years. And that's actually a great message for people to have.

The challenge, of course, will be as we get into good investment return, do we really have the stamina -- maybe that's not the right word -- do we have the discipline to not grab some of those market rates of returns faster than the CalPERS methodology will be.
telling us we should be doing?

    MR. ANGELO: And part of the irony is that when
the market was going up and CalPERS was using three-year
smoothing -- which is not very much smoothing -- even
then they second-guessed their own method, and actually
rather than simply let the method release those gains as
they normally would over three years, they accelerated
that as part of the benefit adoption process. Now,
though, CalPERS is definitely the thought leader:
15-year smoothing. John makes a good point.

    Look at the graph of CalPERS contributions.
They go down, they hit zero, they come up. CalPERS ran
the study, if their current policies had always been in
effect, the rates would have gone like this (indicating),
just a little dip down. That's one piece of the
information.

    The other question to ask is, would we have
been having these pension inequity issues if we did not
have the contribution holiday? So if the current
policies had always been in effect, yes, the
contributions would not have gone down. But to what
extent would that have changed the entire pension
conversation?

    CHAIR PARSKY: I think we're going to call this
to a close now because we're a little bit over. I really
want to thank you all, all three of you very much.

    I want to thank everyone for today.

    We've given out a calendar, trying to determine conflicts for the rest of the year. If you would fill those out, we've only established two future meetings.

    We'd like to do the rest of the year.

    Thank you all very much for the day.

(Proceedings concluded at 4:12 p.m.)
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 6th day of May 2007.

_______________________________
DANIEL P. FELDHAUS
California CSR #6949
Registered Diplomate Reporter
Certified Realtime Reporter