STATE OF CALIFORNIA

PUBLIC EMPLOYEE
POST-EMPLOYMENT BENEFITS COMMISSION

PUBLIC MEETING

Tuesday, November 13, 2007
10:00 a.m.

CalPERS Headquarters
Lincoln Plaza West, Community Room 1600
400 Q Street
Sacramento, California

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

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A P P E A R A N C E S

PUBLIC EMPLOYEE POST-EMPLOYMENT BENEFITS COMMISSION

Commissioners Present

GERRY PARSKY, Commission Chair
Aurora Capital Group

MATTHEW BARGER
Hellman & Friedman LLC

PAUL CAPPITELLI
San Bernardino County Sheriff’s Department

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

JIM HARD
President
Service Employees International Union Local 1000

LEONARD LEE LIPPS
California Teachers’ Association

CURT PRINGLE
Mayor, City of Anaheim

ROBERT WALTON
Retired (CalPERS)

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A P P E A R A N C E S

PUBLIC EMPLOYEE POST-RETIREMENT BENEFITS COMMISSION

PEBC Staff Present

ANNE SHEEHAN
Executive Director

JAN BOEL
Staff Director

TOM BRANAN
Policy Director

STEPHANIE DOUGHERTY
Research Director

MARGIE RAMIREZ WALKER
Office Manager

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Public Testimony

(No public testimony was offered.)

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Subject Matter Experts

JOHN BARTEL
Actuary

TOM DITHRIDGE
Department of Finance

BOB PALMER

--o0o--
Defining Solutions for California:
Draft Recommendations

Welcome

Chair Parsky ................................. 6

Public Comment ............................... (None)

Discussion of Third Concept:

In order to build awareness, support, and
trust by taxpayers, including the employees
of public agencies, the process through
which benefits are adopted, modified and/or
paid for needs to be open, transparent, and
defensible ................................. 9

Encouraging Awareness

• Timeliness of Reporting Data ........ 10

• Increasing Public Awareness ........ 30

Creating an Open and Defensible Process

• Actuarial Review Panel ............... 52

• Actuarial Assumptions ............... 52

• Funding Benefit Changes/Actuarial
  Review of Proposed Benefits ........ 67

• Actions that Hurt the Credibility
  of the System – Spiking and
  Disability fraud ....................... 97
## Table of Contents

<table>
<thead>
<tr>
<th>Item</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discussion of Third Concept: continued</td>
<td></td>
</tr>
<tr>
<td>Building Taxpayer Support and Trust</td>
<td></td>
</tr>
<tr>
<td>• Operational/Administrative Governance</td>
<td>141</td>
</tr>
<tr>
<td>Adjournment</td>
<td>171</td>
</tr>
<tr>
<td>Reporter's Certificate</td>
<td>172</td>
</tr>
</tbody>
</table>

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BE IT REMEMBERED that on Tuesday, November 13, 2007, commencing at the hour of 10:13 a.m., at CalPERS Headquarters, 400 Q Street, Community Room 1600, Sacramento, California, before me, DANIEL P. FELDHAUS, CSR 6949, RDR, CRR, in the state of California, the following proceedings were held:

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(The following proceedings commenced with Mr. Pringle absent from the hearing room.)

CHAIR PARKSY: Ladies and gentlemen, if we could just have everyone's attention.

I apologize for being a little bit delayed, but I want to welcome everyone to the tenth commission meeting.

We've embarked on a process of trying to conduct our hearings throughout the state.

I want to thank CalPERS for making this facility available to us this morning.

And I think the agenda for today's meeting is available to everyone, at the back of the room.

And as I think everyone that has followed us knows, we're in the phase of our commission hearings that is oriented around trying to develop our recommendations that we will be providing in January to the Governor and the legislative leadership. And so this is a
continuation of that. We'll be discussing a specific set of recommendations which have been posted. They're in draft form as developed by the staff.

I just want to make sure that everyone understands that -- I say this at every hearing -- that on the establishment of the Commission, the terms of reference established by the Governor and the legislative leadership made it clear that from the policymakers' standpoint, promises that have been made to public employees with respect to pensions and health care were promises that were to be met.

The purpose of this Commission is not to challenge those promises in any way, but to first identify with some specificity the magnitude of these obligations that exist today and that will accrue; to evaluate various approaches that have been taken, to try to make sure that these promises will be met; and then to come forward with a plan that would address what I think the public is now beginning to become aware of, which is the mounting level of the obligations, especially in the health-care area, that would be characterized as “unfunded obligations”; and what approach this Commission can recommend to the policymakers to try to ensure, in a fiscally responsible way, that these promises will be met. And so that's what we have embarked on.
And we broke down the areas of recommendations into three categories, and in Fresno and Oakland and here we're discussing each of those three categories with recommendations. And so it's meant to be an interchange between the Commission members and the staff.

We have preserved time for public comment at every hearing.

From what the staff tells me, we don't have anyone that has signed up for public comment this morning. If anyone changes their mind, please sign up. But with that being the case, unless any of the Commission members have anything else they'd like to say or -- Anne?

MS. SHEEHAN: No, I don't.

CHAIR PARKSY: We can move right ahead into our discussion of the various recommendations.

So Tom and Stephanie, our two leading staff members. They have been guiding this Commission through the thicket of various subjects. And we'll see how they handle it today. We'll reserve our grade until the end of the day.

Tom, why don't you start us off?

And I think we've distributed, and the public should have a copy of the draft of these.

And, once again, the general concept, I think,
is up on the screen. I'd just remind everyone, the general concept under which these recommendations will be made is defined up there.

And so, Tom, why don't you start with that, and then kind of go into each of the categories? We'll try to get through, according to the agenda, before lunch what's on the list.

MR. BRANAN: Thank you, Mr. Chair.

Is this on?

CHAIR PARKSY: Yes, you're on.

MR. BRANAN: Mr. Chairman, Commissioners.

Actually, if you knew my sense of direction, you probably wouldn't want me leading you through this thicket or any other; but we're into it now.

CHAIR PARKSY: Well, that's why Stephanie is here.

MR. BRANAN: Actually, there's more truth to that than you know.

We have started this first page with the third principle that you've seen. And we've done something different this time which we hope will simplify things, and that is to group the topics that we're going to be hearing under parts of the overall third principle that you see there.

So it says, “In order to build awareness,”
you'll see two things under "Awareness." There's one, "Creating an Open and Defensible Process for Adoption and Payment of Benefits," and then "Building Taxpayer Support and Trust." All of those come from the lead principle at the top of the page.

So we'll turn to those.

The first is: “Timeliness of Reporting Data” and the background information.

“For pensions, all public retirement systems are required to annually report their financial actuarial and benefit status to the State Controller's Office or be fined $5,000.”

The second point: “Government Code section 7504(d) requires the State Controller to publish an annual report on the financial condition of all public retirement systems.”

The third point: “The State Controller's Office has often delayed the publication of this information.”

And I should point out, this is in no way singling out the current occupant of that office. This has been an ongoing, years-long problem for people working in the retirement arena.

Under “OPEB”: “There is no standardized process for collecting and making public OPEB information...
from public agencies.”

Now, this time, we've added some additional information before each of the recommendations to see if we can make them more clear.

In this case, “It is in the public's interest for public retirement systems and employers providing OPEB to report on the status and adequacy of funding for these benefits. Current reporting mechanisms do not provide for the timely and accurate disclosure of pension and OPEB liabilities.”

The first recommendation growing from that is: “Legislation should be introduced directing the State Controller's Office to develop a simple and inexpensive procedure to regularly collect and report OPEB data from California public agencies. The State Controller's Office should publish the report of OPEB data at least once every two years, within nine months of the close of the fiscal year.”

Now, just as additional information, there is a group that addressed you at Fresno, and it's a coalition of local agencies. They've been helping us a great deal gain access to public agencies, both with our survey and our case studies. That group has signed off on this concept. They want there to be a central location where they can submit their OPEB data. And so that includes
the League of Cities, the CSAC with the counties, a
collection of school representatives, and also the
independent special districts.

And the reason we said "every two years" is due
to the GASB requirement that smaller agencies report this
data every three years, and larger ones every two years.
So it really doesn't make sense to have an annual report.

CHAIR PARKSY: Okay, why don't we take them one
recommendation at a time, or you can make comments on
both? Why don't we kind of go through the list?

Lee, do you want to start us off here?

MR. LIPPS: First of all -- is this on?

CHAIR PARKSY: Yes.

MR. LIPPS: First of all, Tom, that's not the
way that I read at least the preamble to these
recommendations.

I see that the recommendation would have the
Controller publish it every two years; but for the
Controller's office to collect this information
regularly, which theoretically could be more than once
every two years, particularly if it's simple and
inexpensive, why wouldn't we want to do it yearly, if we
wanted to have a reporting requirement, is part of the
question.

And the other part of the question is, at what
point would doing this extra work as required result in a mandated cost to the State?

MR. BRANAN: Well, the first point, in terms of why not annual, they can collect it -- certainly this recommendation would not prevent them from collecting anything that was available on an annual basis. We're talking about publishing the data every two years. And the reason, again, is, there's no GASB requirement that they report annually. There is a requirement that they report two years or three years, depending on their size.

CHAIR PARKSY: Your recommendation then really relates to the accessibility of the data?

MR. BRANAN: Well, right now, for OPEB data, there is no source. This Commission, in its survey, is the first group that has gathered such information. And it was difficult to get it.

For one thing, people didn't even really understand what we were asking for. I think local agencies, as well as staff, have learned a lot from figuring out what needed to be reported, how to ask for it. And the feeling among those groups is, let's keep doing that now that it's set up.

CHAIR PARKSY: Well, I think there were two parts to Lee's question, though.

One had to do with, it would suggest that they
were going to collect data; and maybe inherent in that --
they were going to collect data more frequently than the
two-year publication requirement. The first sentence, I
think, might suggest that.

And I think your response was that the data
might not be required to be available except on a
two-year basis?

MR. BRANAN: This is on Recommendation 1?
CHAIR PARKSY: Yes.

MR. BRANAN: Yes, all we said was that they
regularly collect it, and it's up to them to decide how
to do that.

CHAIR PARKSY: I see.

MR. BRANAN: So it isn't available -- new data
is not available annually for an agency that is reporting
based on its GASB requirements.

Now, some of them might have it annually, but
we thought it would just be wasted effort to tell the
Controller that you have to publish this annually, when
there may well not be new data.

CHAIR PARKSY: Maybe you want to reverse the
sentences, and the legislation should require a report
every two years, and then they can collect the data as
they deem fit in order to prepare such a report.

MR. BRANAN: We can certainly do that.
The reason that it's written as it is was from the request of CSAC and the League. They think that by requiring the Controller to come up with a simple, inexpensive procedure, that that is a way that we can address mandated costs.

CHAIR PARKSY: I see.

MR. BRANAN: So that's why we put that first.

MR. LIPPS: But it would still be a mandated cost, regardless of how inexpensive?

MR. BRANAN: I really don't know.

I think we certainly can assume that it would be. But it's something -- it's data that they have to collect, anyway. This would simply be -- the way they do now with the Controller's pension report is, the Controller's staff have developed an electronic form that retirement systems fill out. I would imagine that something like that could be done for OPEB at relatively low cost.

MR. LIPPS: And, really, that was going to be sort of the next part of my question. It seems we already have a similar provision to this on the pension side. This would just apply it to the OPEB side.

The problem hasn't been with collecting the data regardless of the frequency, in terms of pensions.

Apparently the problem has been with the Controller
publishing it in a timely fashion.

MR. BRANAN: That's absolutely right.

MR. LIPPS: Regardless of how simplified they've made it in terms of the Web site.

Is there any chance of fining the controller $5,000?

MR. BRANAN: I didn't hear that.

MR. LIPPS: Is there any chance of fining the Controller $5,000?

MR. BRANAN: Well, we actually --

MR. LIPPS: I know we'd be fining ourselves. I understand how that works.

MR. BRANAN: We have spoken to some people from local retirement systems who have had to pay the $5,000 for not reporting on a timely basis, and then see a year or two go by before it's published. I think they might support your idea.

CHAIR PARKSY: I think the only thing the Commission ought to, I think, step back and understand is that one of the terms of reference for the Commission was to identify the magnitude of these obligations.

So coming out of the Commission, a set of recommendations relating to this being done on an annual basis is very much part of what our charge was, it seems to me. How we word it is clearly open.
Matt, any thoughts on this subject?

MR. BARGER: I guess I have two.

The first one would be, I'm unclear, you really didn't go into any detail why it's late. Is there something cumbersome about the process or is the data inconsistent? Or what was the issue with the existing system?

MR. BRANAN: I don't know currently.

Years ago, when I worked for the Legislature, I dealt with -- there were two people in the Controller's office that were responsible for this report. Their complaint at the time was, they just -- they were very low priority within the internal hierarchy, as far as staff and computer time. That's been 20 years ago. I don't know what the cause is but the problem is still there.

MR. BARGER: It just seems like it's one of those classic things somebody can put it into a computer on one end and then just go onto a spreadsheet and "boom."

MR. BRANAN: I think that's probably true.

When I was concerned with it, it was all manual input from paper submissions by the retirement systems. So it would seem that it would be simplified now.

MR. BARGER: Right. I mean it's one thing for
us to sort of dictate that it should be timely if there's some underlying cause that's the problem.

MR. BRANAN: I've never heard an explanation from the Controller's office.

MR. BRANAN: A priority?

CHAIR PARKSY: Well, just to follow. And there may be something that could be included in the legislation -- I don't know whether it's cost or whether it's time or whatever it is, but I think it's a valid point. If there's something that's needed from the Controller's office in order to make sure that this could be honored, we ought to find out about that before the final recommendations are put forward.

MR. BRANAN: That's true.

What we had in mind was, since this is going to be put through the Legislature, that as part of publishing what the legislation would look like, those items would be discussed.

MR. BARGER: They'd be discussed?

The other point I would have is just a consistency point. In other words, how do you address sort of the garbage-in, garbage-out, if people have different standards about what, say, health-care inflation is or mortality assumptions? How do you actually get this information to be consistent and useful
with this recommendation?

    MR. BRANAN: For which reporting requirement?
    MR. BARGER: The OPEB liability.
    MR. BRANAN: That's a good point.

    And as I said, right now there is very little
in the way of those kinds of assurances, but it's never
been really reported on a systematic basis before.

    CSAC took a stab at this a couple years ago,
the League of Cities did. But I think the work of this
Commission has been much more far-flung and systematic.

    I could only suggest that people would build
off of what Commission staff has done, and to come up
with something that would be satisfactory in those terms.

    MR. BARGER: I mean, it strikes me when one of
the things we're supposed to do is come up with a
magnitude and have a transparent process, et cetera. All
you do is have 50 different assumptions. It's sort of a
hodgepodge of stuff.

    MR. BRANAN: Well, what we've collected is
really not assumption-driven but hard data in terms of
how many people they have, what benefits have they
promised, are they prefunding, those kinds of things.

    MR. BARGER: Yes. But aren't you actually
trying to take all that and come up with a number?
    MR. BRANAN: Yes.
MR. BARGER: And that is dependent on mortality assumptions, health-care inflation?

MR. BRANAN: That is, yes.

MR. BARGER: To a big extent; right?

MR. BRANAN: Yes.

CHAIR PARKSY: Well, is your point, though, Matt, that there ought to be some --

MR. BARGER: Without a consistency standard about the consistency of, you know, what the inputs are -- you know, you're just at risk to me, anyway, of ending up with a bunch of stuff that's not really comparable.

MR. BRANAN: The collection of data, that's hard data, that's what we've gotten.

The Controller certainly has an accomplished actuarial staff. They could work on that, and the legislation could also set out some guidelines.

MR. BARGER: Well, to me, that seems like an important thing to do. There ought to be guidelines to provide the consistency of input or, you know, something along those lines.

MR. BRANAN: Well, there is something of a model there with the legislation that required annual pension-system reporting. There is a checklist there of things that, at a minimum, should be included. And some
of those are actuarial assumptions.

MR. BARGER: So the equivalent would be, you know, what are your health-care assumptions, what are your health-care inflation assumptions, what are your mortality assumptions -- you know, what are the drivers in terms of your assumptions. So even if you didn't happen to use the same ones, at least you would have information on what people are using?

MR. BRANAN: Yes. And that was done with the pension legislation some years ago.

MR. BARGER: To me, that's something that would be important for us to suggest that they have in this.

CHAIR PARKSY: Yes, I think at the heart of these recommendations was the issue of data and timeliness. But I think Matt's point is that, well, the collection of the data needs to then include a methodology that is consistent across the board so that the end result will be utilizing the same methodology so if you annually publish something, it would be consistent.

So I think maybe we ought to add -- maybe it's a section that deals with methodology as opposed to just the timeliness of it, what the report should be based on or what input should there be.

MR. BRANAN: If you have your background
document, that's the bottom one. On page 3, you'll see reference, and under that code section 7502. And there is a set of considerations and assumptions that should be considered. So we certainly could include similar language.

MR. BARGER: Yes.

CHAIR PARKSY: Yes, that would be very good. Okay, yes? Let's continue.

MR. CAPPITELLI: Yes. Overall, I support this concept. I think this is good.

My only question is, in reading through this here, 7504 requires that -- it only requires that the Controller compile and publish this report on an annual basis.

And if we're suggesting that there is other data that comes out every two years, I wonder why we couldn't just say, in the annual report include the data that includes the OPEB liability. I mean, that's easier said than done. But it seems to me if you have an annual report and you're going to the agencies to get them to submit the information for the report, to me, it would be just as easy to include that report on an annual basis rather than every two years.

MR. BRANAN: Well, Commissioner, we could do that. And the reason we didn't in this case was, we
wanted to clearly set out the fact that we wanted to
create a new report for OPEB, and we wanted to improve
the timeliness for an existing report.

So they certainly could be combined somewhere
down the line, but we thought it would be clearer when we
were discussing them to have a recommendation based on a
needed report and one based on an existing report that
just has a particular problem.

MR. CAPPITELLI: And in the end, I think either
will work.

My only -- my main reason for bringing this
up is if this is something -- if our goal here is to
try to make this more transparent, from the public's
perspective, I would rather it be one-stop shopping. I
would rather be able to go to a particular place to get
a report and be able to see at a glance everything that
was happening in OPEB and also in pensions. But, you
know, however it's presented I guess would be something
that could be vetted out through the process; but that
was the only suggestion.

MR. BRANAN: That would certainly make sense.
And since the existing report is to be produced annually,
anyway, the OPEB could be included as a chapter.

MR. CAPPITELLI: Okay.

CHAIR PARKSY: Bob?
MR. WALTON: Thank you.

Yes, I certainly support the concept of what staff has recommended. I would kind of follow what Paul has indicated, that one report would be better.

The difficulty, in my experience, with the current report on pensions, is that it is not very timely. And it's a matter of priority and staffing at the State Controller.

And this is not in any way to discredit them; they're reacting to it for the need for the demand of this report, which is little, if any, in the current situation. I think what this Commission has an opportunity to do is emphasize how important this information is.

As I recall that report, to address some of Matt's concerns, is there's tables that indicate for pensions what methodology did you use: Entry-age normal, unit credit. What assumptions do you use as far as interest return, that sort of thing, amortization of unfunded liability, so all that information is there. It can be different, but there's a source to tell you what the ultimate liability is based on.

And you could do the same thing for OPEB. It certainly probably will be different than pension for a number of reasons, but there is no reason why they
couldn't be combined if it's operationally possible.

I think the context of what staff is recommending is, currently there is a central repository of information for pensions. That is not timely, but it's there. And we want something similar for OPEB. And then to put more emphasis on getting this information out there.

I would suggest that instead of this Commission trying to design what the parameters ought to be, that like there was established under the pension legislation, that we recommend an advisory committee be established that includes actuaries, people that are expert on the health side of the aisle, to set those parameters for the Controller to make this reporting a part of the normal process.

Also, I think part of the problem the Controller faces now is it's been a paper product. It's not an online document, as far as I know. It never has been. And they're only as timely as their latest report. And if this could be put more -- and updated periodically based on whatever information is available, you wouldn't have to wait for the last person; you could do it on an ongoing basis. As information comes in and it's reviewed and determined to be accurate, it's updated to file. So anybody could access it at any point in time to get the
most current information available.

CHAIR PARKSY: I think you could add that, Tom, that concept.

Jim?

MR. HARD: I think you folks have covered everything that I would.

Teresa?

DR. GHILARUCCI: Perhaps this language would work. Just right after “within nine months of the close of the fiscal year,” so that it is: “The State Controller's Office should publish a report of OPEB data at least once every two years within nine months of the close of the fiscal year following best-practice guidelines issued by the Controller's office.”

And then the implication would be that the best practices would be reviewed by the actuarial review board that we're going to talk about later.

But it makes -- I really like the way this discussion went because one of the charges of this Commission was to bring in pensions and OPEB on sort of the same treatment, the same importance. And so probably when we look at that actuarial review board, that they would also be charged with looking at the OPEB assumptions and review those as well.

You probably had that in mind, but I didn't
read it when I first saw it.

So I guess what we're doing now is -- is this right, that we're saying that we want the Controller's office to issue guidelines to the entities about how to report the data? Is that the issue here?

CHAIR PARKSY: Well, collect it -- certainly collect the data; and then through a system that is uniform, convert the data into information that can be made public on the magnitude of the obligations.

DR. GHILARUDDI: Yes, I was being a little more proscriptive. That the Controller's office actually tell the agencies what assumptions to use or random assumptions. So I was actually being a little heavy-handed.

MR. HARD: Yes, that I don't think -- I don't know how that would work, you know, to -- I don't think that's actually -- that would definitely require legislative change.

DR. GHILARUDDI: Right. Well, that's what they're doing.

MR. HARD: Yeah, but I don't know that that one would fly, for us to tell them how to do their actuarial assumptions, although it might be more uniform. But I would doubt its ability to get passed.

MR. BRANAN: I think those details would come
out of the collaborative process --

DR. GHILARUDUCI: The legislative, yes.

MR. BRANAN: -- in the Legislature.

Before they would write something like this, they would talk to -- in essence, they would create an ad hoc group, like Bob is talking about.

DR. GHILARUDUCI: But we have to decide how proscriptive we'd like to be as a commission.

CHAIR PARKSY: That's true.

Well, I guess maybe you can use what happened on the pension side as illustrative.

DR. GHILARUDUCI: Yes.

CHAIR PARKSY: And maybe we'll build into the recommendation that -- the suggestion that there be an advisory group and that the advisory group -- I mean, the process should result in the public having an awareness of the magnitude of these obligations and that the methodology be made clear so that it could be done.

So maybe we want to include what the advisory panel would be asked to advise on, along those lines.

MR. BRANAN: I think we can build this recommendation based on the comments here, as well as these code sections that establish what is actually a very successful data-gathering process for pensions.

CHAIR PARKSY: Exactly. Use that as an
example.

DR. GHILARUCCI: Yes.

MR. CAPPITELLI: I have one final question on this.

CHAIR PARKSY: Sure.

MR. CAPPITELLI: This would be compulsory for the Controller's office.

Does it automatically imply that it would be compulsory for the agencies or entities to submit the information?

MR. BRANAN: I believe it is compulsory for retirement systems; isn't it?

DR. GHILARUCCI: Yes, that's one of the codes you gave us.

MR. BRANAN: So I would think that it would be compulsory although this idea came from local agencies.

MR. CAPPITELLI: I would only suggest that we just ensure that there is some emphasis placed on that, because I'd hate to see a report that had -- similarly to when you did your surveys, if, you know, you had a 100 percent response from everybody all the time. But if it was not compulsory, then it might leave the door open for people to make it a low priority.

CHAIR PARKSY: Well, and, again, if you're modeling it after what was adopted on the pension side,
and if the legislation put that compulsory aspect in it, there's no reason that it couldn't do it on the OPEB side.

MR. BRANAN: That's correct.

CHAIR PARKSY: Yes, Lee?

MR. LIPPS: In general, I'm very much in favor of combining everything into one report as well, for the same reason that Paul mentioned. One-stop-shopping, particularly if it's simplified and all the rest of that.

The problem that I see at the local agency level is that there are a number of local agencies that do not report -- they don't carry their own pensions. Most school districts, for example. What they would have, many of them would have retiree benefits. So that would be a problem that would have to be ironed out.

For those that do carry their own pension systems, incorporating the OPEB piece shouldn't be -- I don't see that as a big deal. It's just when they're not normally reporting pension figures, then reporting the OPEB piece.

CHAIR PARKSY: Okay, any other comments?

You have appropriate guidance there?

MR. BRANAN: Yes, sir.

The second topic is "Increasing Public Transparency" and the background material.
For pensions, "For both state and local agencies, existing law requires that if an agreement provides for an increase in retirement benefits, the cost of the benefit enhancement must be made public at least two weeks prior to the adoption."

The next point: "Required cost information must be prepared by an actuary and contain information on the 'future annual cost' of the retirement benefit. There is no requirement for the cost information to be presented in an easy-to-understand format."

For OPEB: "No comparable cost-disclosure statute exists."

Draft recommendations, "Although existing law requires public disclosure of proposed pension benefit changes prior to adoption, some local agencies place the proposal on the consent calendar where it passes without discussion. Existing 'sunshine' provisions for pensions do not apply to changes in retiree or active health-care benefits."

The third recommendation is, "Existing state law, Government Code section 7507 which requires specific public notice concerning the cost of proposed pension benefits, should be amended to also apply to the granting or changing of OPEB benefits. This statutory change would require that the future costs of the proposed OPEB
benefit change be determined by an actuary and made public at least two weeks prior to adoption."

And would you like me to read the next one as well?

CHAIR PARKSY: We'll only stay with this first and then we'll go on.

MR. BRANAN: Okay.

CHAIR PARKSY: Comments on this recommendation? Lee?

We'll start from the right and move to the left for a few, and then we'll move from left to right.

MR. LIPPS: Gerry, I've never been on the right.

CHAIR PARSKY: Well, you're on my left.

MR. BARGER: Far left.

MR. LIPPS: And especially the far right.

CHAIR PARKSY: At the end of the Commission process, tell me how you feel.

MR. LIPPS: From a practical matter, Tom, this completely does not work for a variety of reasons for public education agencies.

The first would be the immense cost. If, for example, during the course of local negotiations, and OPEB benefits were all locally negotiated by the seven, nine hundred -- almost a thousand school districts, if
you were going to do a benefit increase, and
presumably -- I'm just looking at the language again --
and even presumably a decrease, because it just refers to
a benefits change, if the requirement were to have it be
projected out by an actuary, that's a very expensive
process, first of all, for a local school district to
have to engage in, even though the change might be
relatively minor.

The second part of that is that then to require
it two weeks prior to its adoption by the parties,
negotiations just don't work that way. You have
negotiations, at some point you have an agreement. The
school districts are required to do their own kind of
sunshining period under AB 1200, and then the school
board adopts and the teachers or the classified
association adopts. And how long you would have to wait
before an actuary could put together projections, that
would be very, very unmanageable.

MR. BRANAN: Just on that one point, if I could
clarify. That's not talking about -- the adoption
referred to there is the adoption by the agency of the
new benefit. So the bargaining process is over.

MR. LIPPS: But the agency that bargained the
benefit, at least in the case of education agencies, are
going to be local school districts. And a lot of those
benefits go into effect immediately upon adoption, both by the ratification by the school board and by the employee union, whether it's the classified side or the teachers' side. So where that might work, perhaps -- when we're talking about an agency like CalPERS and their OPEB benefit structure, it might work at the state level. I don't see it working at the local level, at least for a lot of the very small agencies like school districts and perhaps some of the others.

CHAIR PARKSY: And is that because of the time of adoption?

MR. LIPPS: Both time and money. You know, the money to actually go out and get an actuarial valuation of the cost of this prospective new benefit, and then you have to put it out there for public comment. It doesn't -- the time period would be almost prohibitive.

CHAIR PARKSY: Well, I'm not quite sure public comment is inherent in the recommendations. I think inherent in the recommendation is the desire to make the public aware, in a clear way, of changes on the health-care side comparable to the pension side.

And so I guess the first question is, if the actuarial analysis is expensive, what is done as part of the bargaining process to know what the magnitude of what is being adopted?
MR. LIPPS: If what is done is under AB 1200, when an agreement is reached that has cost implications, the school district is required to project what it's going to cost it this year and each of the next two years.

And as part of that disclosure, they have to project out their budgets for each of the next two years, estimating beginning balance, ending balance, with all of these additional costs projected. But it's a three-year projection; it's not a 30-year projection.

CHAIR PARKSY: I see.

MR. LIPPS: But if something -- you know how many retirees -- or if it's even not the retirees, if it's just an increase in benefits for active employees, you know how many employees you're going to have. You've got ABA projections, you know how many employees you're going to have, either up or down, and you can project these costs reasonably accurately over the course of three years.

MR. BARGER: Do they calculate normal cost or a pay-go cost?

DR. GHILARUCCI: Pay-go.

MR. LIPPS: Pay-go. It's a pay-go projection for the current year into the next two.

CHAIR PARKSY: Well, I guess. But if we're
trying to suggest to local authorities that the magnitude of these obligations need to be identified, and with a methodology that is consistent, let the public know what it is that is being accrued, how do we deal with that in the context of the local educational entities?

I mean, what is it that --

MR. LIPPS: First of all, I think that you let the public know what is the cost -- which is current now -- what is the cost of increasing this benefit or decreasing this benefit this year, what impact does it have on this year's budget.

CHAIR PARKSY: Okay.

MR. LIPPS: And also part of the requirement is, what budget adjustments are we going to make this year in order to afford that? That is part of the AB 1200 process.

CHAIR PARKSY: Okay.

MR. LIPPS: Then the projections for each of the next two years, as Matt pointed out or questioned, are on a pay-go basis. And, again, you have to show that you're going to have reserves and so on.

I think you leave it up to the local entity -- school business officials, the superintendent, management, teachers' association -- as they project costs out in future years, again, on a pay-go basis, they
make budget adjustments as necessary so that they can fund the current year's obligations.

And each year, remember, they still have to project another two years out into the future. So they also have to project out what changes are they going to make if the reserves begin dwindling, either drastically, or certainly below the 3 percent, or whatever percent reserve they're required to have, 1, 2, 3, 4, 5 percent.

So there is an adjustment mechanism that's put into place every year because you always have to project out an additional two years, but it is done on a pay-go basis.

But then also you do let the public know in the first year what the cost of this benefit is for the current year and each of the next two years.

CHAIR PARKSY: Well, the data that we are collecting, how does it different from what we just said in terms of any actuarial analysis?

MS. DOUGHERTY: Are you talking about the current OPEB survey?

DR. GHILARDOCCI: Well, pensions, too.

CHAIR PARKSY: Yes, either. But we are now collecting data from the same entities on a voluntary basis.

Are they providing us only the data just
described, or are they providing us data that would
suggest that they did an actuarial analysis going
forward?

MS. DOUGHERTY: What we've asked them for are
their annual OPEB costs, and then what their
pay-as-you-go cost is; and, if they are prefunding, what
are they currently setting aside for prefunding.

DR. GHILARDOCCI: That's not quite the
question. It's now they're required to report the
pension costs. Do they report the actuarial liability
over 30 years, or is it just the pay-as-you-go -- the
normal cost of the pay-as-you-go cost?

MS. DOUGHERTY: Under the AB 1200?

DR. GHILARDOCCI: Yes.

MS. DOUGHERTY: (Nodding head.)

MR. BRANAN: I don’t know. I’m not familiar
with 1200.

MR. LIPPS: Actually, I do. For public
education agencies that offer post-employment benefits --

DR. GHILARDOCCI: Yes, okay.

MR. LIPPS: -- past age 65 -- only past age 65,
not up to age 65 --

DR. GHILARDOCCI: Right.

MR. LIPPS: -- and they are required to have
an actuarial valuation every three years. And what they
have to disclose in their adopted budget in the criteria and standards pages is, what is the projected cost of their -- what is their OPEB valuation and what was the date of the last OPEB valuation. So that's current law.

DR. GHILARDUCCI: So why is this a problem?

CHAIR PARKSY: Yes, that's my next question.

MR. LIPPS: Why? Because this is done every three years, not every time a benefit is approved.

DR. GHILARDUCCI: Okay.

MR. LIPPS: This would apply -- could apply to any negotiation in any given year if a benefit is approved or, theoretically, if a benefit was decreased.

And, again, for those districts where the additional cost comes in for most districts is, most school districts do not offer retiree benefits past age 65.

CHAIR PARKSY: Well, what if -- and I don't know whether this would be responsive -- but what if the recommendation with respect to local school districts had a requirement that as they publish every three years their actuarial analysis, they include a separate section that deals with the increased benefits that have been created since the last publication?

MR. LIPPS: Well, I think that's almost implicit in what GASB 45 is now currently requiring;
because any school district that offers retiree benefits
has to do this actuarial valuation at least every two
years.

DR. GHILARDUCCI: Every two years?

MR. LIPPS: Which will not be without -- or
three years, if you're below a certain size --

DR. GHILARDUCCI: Okay.

MR. LIPPS: -- which would not be without its
costs. But they are going to be required to publish the
actuarial valuation of what those OPEB liabilities are.
So I think that's what GASB 45 is currently requiring.

What may not be apparent, which may have been
implicit, Gerry, in your question, is if somebody looks
at an actuarial valuation of let's say $40 million three
years ago, and this year it's $60 million, you may not
know if that is a result of increased benefits or if that
is a result of changed actuarial assumptions.

CHAIR PARKSY: Right.

MR. LIPPS: You may have changed -- an
actuarial firm that may have changed the assumptions.
There could be any number of reasons why the number was
different. And in a parallel way, if the number went
down as well.

So it doesn't get exactly to what you were
asking; but I believe school districts at this point,
anybody that offers any school district -- any school
district that offers a retiree benefit is going to have
to have these actuarial valuations.

CHAIR PARKSY: And at the time of adoption of
new benefits, that analysis isn't done?

DR. GHILARUCCI: Is not done.

MR. LIPPS: No.

DR. GHILARUCCI: Is not done.

CHAIR PARKSY: Well, what about -- Lee, we'll
come back to the local school districts.

What about every other entity that we are
looking at?

MR. BRANAN: For other public entities -- and
you'll see this on page 8, it gives the text of
Government Code 7507. "The Legislature and local
legislative bodies shall..." So it applies to all local
agencies, I would say with a -- I'm not sure if that
would exclude school boards or not; but certainly city
councils, boards of supervisors, the boards of special
districts do have to comply with 7507. That's the basis
of the recommendation.

CHAIR PARKSY: And, Lee, do you know whether or
not the local school districts are covered by 7507?

MR. LIPPS: Let me take a look at 7507 again
before I answer that question.
CHAIR PARKSY: Okay.

But inherent in the recommendation is to create a parallel requirement to this?

MR. BRANAN: That's correct. In fact, in several of the recommendations today, you'll see that the idea behind them is to take a third party, a neutral party, and inject them into the decisions being made for benefit changes.

DR. GHILARUCCI: Right.

CHAIR PARKSY: Which, in and of itself, a process has been done on the pension side?

MR. BRANAN: That's correct.

MR. LIPPS: Gerry, this wouldn't apply to local school-district agencies because it only refers to pension benefits. And those pension benefits are out of the hands of local school districts. That’s all done at the CalSTRS agency.

CHAIR PARKSY: Well, I do think a broad approach by this Commission to send a signal that consistency of reporting data and information with respect to health-care benefits paralleling what I think is in place on the pension side sounds like a sensible thing to do if we're really trying to identify the magnitude of these costs and make the public aware of them.
Now, I think we need to be sensitive to what is practical. But isn't that inherent in what you're suggesting, Tom, to basically move in that direction?

MR. BRANAN: Yes, that's our goal as staff, is to open these up, these processes and decisions to the public, and to have a third party involved to come up with the costs.

CHAIR PARKSY: Well, and with certain exceptions. If it's been accepted on the pension side, I'm not quite sure why it wouldn't be accepted on the health-care side.

MR. LIPPS: Again, Gerry, in theory, there's not a problem with that, except that on the pension side, most pensions are covered by large state agencies. The local public agency doesn't have to do any reporting. That's all compiled at the state level if we're talking about CalSTRS, CalPERS, and some of the larger independent systems.

The local school districts -- and I'm sure that there are other public agencies as well -- don't have this pension-reporting requirement on an annual or biannual basis because they belong to part of the larger system.

CHAIR PARKSY: Well, I think maybe in recrafting this recommendation, maybe we want to
differentiate in terms of what the state agencies can do
and what the local agencies may do. I don't know how
we're going to acknowledge, or make the recommendation
with respect to legislation, acknowledge those
differences.

MR. BRANAN: We'll certainly look into
necessary changes for the school districts. But I really
don't think there's any argument against including other
local agencies in this recommendation.

CHAIR PARKSY: Right.

MR. BRANAN: Even if a city contracts with PERS
for health care, that city is still choosing a certain
health-care package. And it does have a cost; and I
would think they could get -- I know they can get costs
from PERS or they could hire their own actuary.

CHAIR PARKSY: Let's see if we can only
acknowledge the issues relating to local school districts
then.

MR. BRANAN: Okay.

CHAIR PARKSY: Any other comments on that
recommendation?

Sorry, Bob?

MR. WALTON: Yes, thank you.

I think the theme of increased transparency is
very important, not only from the view of the employer,
the plan sponsor, but also the member; but even more importantly I think from the general public, as far as credibility and what public agencies and public members are agreeing to in their benefit package, both in the retirement and pensions and health.

Several things I think I would characterize as somewhat minor. I'm not sure that the actuary, an enrolled actuary would be the best person to present an item before a local governing board. No disrespect to actuaries; but to have them present it in a layperson's understanding may be an oxymoron, I'm not sure. But nevertheless, I think at a minimum, actuaries ought to be present to explain the financials. There ought to be a requirement, whether it's a CalPERS actuary or someone that the local government wants to bring in is fine.

CHAIR PARKSY: We gave the actuarial community one of these commission sessions, and all of them could come forward in that one session. They succeeded in confusing the entire Commission during that one session, but that's perfectly okay.

MR. WALTON: I wasn't too confused, so I questioned my credibility in this area.

Disclosure of cost. The current law requires for pensions the future annual cost. I think that ought to be expanded. Part of the problems that we saw in the
late nineties -- when most systems were flush with overfunding -- is, often, the future annual cost would be shown as zero because there were sufficient surpluses to pay for the ongoing cost. That misled people to say that the benefits don't cost anything, which, of course, is foolish; they do cost something.

So I think we need to expand both what the current law requires for pensions, as well as OPEB benefits, to be more inclusive of the true total cost, not just the future annual cost. What's the normal cost ongoing, what's the unfunded liability being created, and how is that unfunded liability going to be paid, whether there's sufficient surpluses or whether it's going to be amortized over a set period of time.

It's not unlike when you go in and sign the closing papers for a mortgage. You have to sign a document that says, "I acknowledge this is my cost, this is my annual payment, this is my total payment over time." It's something like that.

And to that extent, I would have a requirement, the head of the local governing body that is approving benefits has to sign a document acknowledging these costs.

Currently, they have to be in a public setting; but, as you say, often it’s consent and it’s passed among
many other things and isn't really noticed. And I think it ought to be carved out and highlighted.

The other -- and, Tom, I don't know if you plan to have it somewhere else -- but something I've brought up before is, I think in approving benefit changes, both in pension and health by the governing board ought not to be made contingent upon action by the plan administrator -- a retirement board, or whoever is over the OPEB trust, as we've seen in the past. So it's not only at times the retirement system, quote, unquote, manipulating the actuarial to make it more attractive, it's also the employer's side, the plan sponsor, the governing board, putting criteria contingencies: "We approve these benefits only if the retirement board does X, Y, or Z." I think that ought to be eliminated and not allowed.

MR. BRANAN: We do have a recommendation on that later today.

MR. WALTON: Okay, and I think that's it. Thanks.

CHAIR PARKSY: Okay, go ahead -- sorry, Jim?

MR. HARD: Well, I do think that this is overall a good recommendation.

I'm not sure -- I'd like to hear more from Bob maybe sometime about the last couple things that were
brought up about a document signed by the local agency
head, and also the projection on how things are going to
be funded. It seems like the cost is one thing, but the
funding of it is a political question that an agency has
to deal with. And if they are an agency that has a
taxing authority, then it's a question of either raising
revenue or cutting other expenses and balancing out. So
I guess I got a little lost on the last two pieces, and
so I'm not sure about those two.

MR. BRANAN: Commissioner Hard, I think that
the part about finding a funding source came from
Commissioner Lipps' description of the process at the
local school level. But for this recommendation, there's
no such requirement.

MR. HARD: Right. I understood that. But I
was just listening to Bob. I always listen to him.

DR. GHILARDUCCI: Yes, I wanted to clarify
that.

Bob, you're getting fun.

You ought to bring Sarbanes-Oxley to
California.

CHAIR PARKSY: Not every acknowledgment goes
directly into Sarbanes-Oxley.

DR. GHILARDUCCI: Well, I heard a little
passion there.
It seems like what you want to do is actually expand 7507?

MR. WALTON: Correct.

DR. GHILARDUCCI: Got it. Okay.

And then you want 7507 to -- the language would be "an actuarial impact on future annual costs before authorizing the increases."

You say that's not responsible enough?

MR. WALTON: Well, I think it can be misleading. As I said, in the late nineties, you may have a system that -- a plan that is 130 percent funded.

DR. GHILARDUCCI: Sure.

MR. WALTON: And so there's no increase annually in cost.

DR. GHILARDUCCI: I understand it. Oh, so you would like it -- I just want to know what you would like it to be -- the actuarial impact -- I see. You would want --

MR. WALTON: The increase in normal costs.

DR. GHILARDUCCI: -- a statement of future liabilities.

MR. WALTON: What’s the increase in normal cost. There's always an increase in normal cost if there's a benefit.

DR. GHILARDUCCI: The liabilities?
MR. WALTON: Correct.

DR. GHILARDECCCI: You want liabilities to be restated?

MR. WALTON: And what's the increase in unfunded liabilities if this is a retroactive benefit applying to past service.

DR. GHILARDECCCI: Sure. So you really just want one word change?

MR. WALTON: I'm not sure if one is right. The actuaries could tell me better what --

DR. GHILARDECCCI: But you want liabilities reported, not costs?

MR. WALTON: Yes.

DR. GHILARDECCCI: Got it.

MR. WALTON: Both.

CHAIR PARKSY: He wants normal costs.

MR. WALTON: I want normal cost, I want unfunded liability. I want all of that disclosed. Again, it's not unlike what you do when you acknowledge your mortgage statement.

DR. GHILARDECCCI: I understand.

MR. WALTON: When you sign your closing papers, you acknowledge the monthly payment, the total cost, what's going to be paid over time, that sort of thing; and not where those funds are going to be coming from.
DR. GHILARDUCCI: And you wanted who to sign the document?

MR. WALTON: I want the head of the governing board. Because often -- and CalPERS can tell you their experience -- in later years, when somebody challenges why this is done, they claim, "We didn't know there was a cost to it" --

DR. GHILARDUCCI: Got it, okay.

MR. WALTON: -- when, in fact, they did.

CHAIR PARKSY: John?

That, in part, keys into Recommendation 4 as well as 3?

MR. WALTON: Yes.

MR. BRANAN: Yes.

DR. GHILARDUCCI: It does.

CHAIR PARKSY: Do you think you have that concept?

MR. BRANAN: Yes.

CHAIR PARKSY: That was a hesitant "yes."

MR. BRANAN: The only hesitation in not understanding, do you still want to take up 4 or do you think it's covered?

CHAIR PARKSY: Well, there may be some other -- any other comments on 4; but I think Bob's comments fit in with 4.
MR. WALTON: Yes, that was my intent.

CHAIR PARKSY: Yes.

Any other comments on -- do you want to -- any other thing you want to say about 4 before we move off of it?

It's pretty straightforward, but go ahead.

MR. BRANAN: No. Actually I was just going to read it. But if everybody understands it, I might muddy the water.

CHAIR PARKSY: If you want to have mud, it's okay. You can throw in a little mud.

Any questions on Number 4?

DR. GHILARDELLI: No, we did it.

MR. HARD: It seems like it was covered.

CHAIR PARKSY: Okay, go ahead.

MR. BRANAN: The next topic is the “Actuarial Review Panel” and “Actuarial Assumptions."

For pensions: “Current law requires each public retirement system to conduct an actuarial valuation at least once every three years; and to have annual financial audits and submit annual financial reports to the Controller.”

"CalPERS and CalSTRS employ full-time actuaries and also contract with outside actuarial consulting firms to perform annual parallel valuations."

I should say also that several of the '37 Act requirement systems, that's two of them also.

For OPEB, “There is no similar statutory requirements for OPEB.”

The next point is, "Actuaries are responsible for making method and assumption recommendations to retirement system boards. Ultimately, retirement system boards have the constitutional authority to select methods and assumptions."

"Some retirement system boards have at times used this selection process to encourage benefit improvements."

And two examples that we put here, you've heard before, sitting as the Commission, in the late nineteen nineties the PERS board offered to increase the value of assets of any agency that would provide enhanced benefits to its employees.

And you heard in the City of San Diego, this wasn't an actuarial failing, it was more of a political failing, but the City Council made recommendations that were based on things other than the actuarial assumptions: Primarily, political considerations and funding changes.

The next point: "General opinion is that the above examples did not violate actuarial standards of
practice. However, they did not encourage best practice."

"In addition, several California public pensions have also experienced significant problems regarding the quality and/or accuracy of their actuarial studies.

Recommendations: "The actuarial standards of practice from the American Academy of Actuaries only addresses actuaries who practice outside the acceptable range of practice and do not help actuaries and boards select best-practice methods and assumptions."

Recommendation 5: "In order to encourage greater transparency and understanding of actuarial methodology and assumptions, there should be a California actuarial advisory panel created at the state level. This panel should be within the office of the State Auditor. Permanent staff should be assigned to support the activities of the advisory panel."

CHAIR PARKSY: Comments? Both about the panel or where it's located or any other comments?

Bob?

MR. WALTON: I think this recommendation has a lot of merit. I'm not sure I wouldn't take it a little further than what's being proposed here. Currently, benefits for state employees,
classified school members, teachers, are done at the statewide level through legislation. They can't be bargained at the local level. And the respective retirement systems perform actuarial analysis on benefit improvements for those groups. Those are generally discussed through both the legislative policy committee, as well as appropriation before they're passed.

I think it would be helpful if there was a function at a statewide level, perhaps within the Legislative Analyst's office, that could add their expertise in this area.

Currently, I don't believe the Leg. Analyst has a staff actuary available. I think it would be helpful if they did. It might be a better place to locate this rather than the State Auditor; but I'm flexible on that.

The bottom line is, I know some other states actually have a state actuary that, before legislation can be considered to improve or change benefits, the State Actuary has to prepare a report and testify on the cost of those benefits.

I'm not sure we have to go that far; but that capability, at least, ought to be within California. And I think that would provide credibility to the numbers that's being discussed.

MR. BRANAN: In terms of where this advisory
panel would be housed, we also first thought of the Leg. Analyst. But we settled on the State Auditor because that office already has audit authority, and we thought that it would be -- an audit often needs an actuarial component, and we thought that this could be a helpful combination of the audit authority and the expertise of the advisory panel.

MR. WALTON: To me, the location, as long as the expertise are there -- and the audit is usually thought of in the concept of post-facto, after the fact. And I would want that work done as legislation is being considered and not just after the fact.

The State Auditor normally doesn't testify before policy and appropriation committees. And that's what I was looking for.

CHAIR PARKSY: Other comments?

Yes, Paul?

MR. CAPPITELLI: Is this something that we are suggesting be done prospectively, or is this something that would be done retroactively, or to look at the existing benefits?

MR. BRANAN: What we had in mind, primarily, was prospectively. That this would be, in essence, a clearinghouse that retirement systems, boards of trustees, various groups that are interested in this
could run, say, a local actuarial practice by this group
and get a reaction from them on how it fits in with best
practices.

MR. CAPPITELLI: Okay, but the question that
comes to my mind as the reason we are here is because
somewhere along the line it is our sense that some of
this may have gone off-track. So does this -- by putting
this in place then, then all of a sudden, everybody, you
know, stands still, the deer in the headlights, and say,"Oh, we'd better straighten up and fly by this," or do we
have a means by which we should go back or should
encourage analysis of things that are already in place?

MR. BRANAN: I would say primarily the former.
But I would like for John Bartel to -- he is
the actuary -- one of our two actuaries on staff.

MR. BARTEL: Inherent in best practice is to
look at benefit improvements, quantifying future benefit
improvements, but it's also looking at current funding,
current contribution rates. So I think inherent in what
you're asking about is the nature of best practice.

MR. WALTON: I would say this also goes to the
previous discussion about transparency, about the
advisory panel would recommend, "Here's what we think
ought to be disclosed when government is considering
benefit improvements."
It goes back to the last meeting, where,
"Here's the best practices as it relates to the
amortization of unfunded liability, or the smoothing of
assets or those things." That's what the advisory panel
would do, is a whole arena of actual policies and
practices.

MR. BRANAN: That's correct.

And if you'll look on page 10 of the background
document, we listed arguments for establishing such a
review panel, as well as possible responsibilities.

MR. WALTON: Okay.

CHAIR PARKSY: And I think what will be
important, as each of these recommendations are developed
for the report, that they're placed in the right context,
so that this background material would be provided either
around or before we actually get to the recommendation.

Isn't that what you had in mind, Tom?

MR. BRANAN: Yes, that's correct.

CHAIR PARKSY: Lee?

MR. LIPPS: In general, I'm not opposed to the
concept, but I can't help but being struck by the idea
that this recommendation is almost analogous to a panel
that would be very similar to GASB, and that would make
recommendations of best practices, it would be advisory,
no binding of law.
If you don't follow their recommendations or what they think are best practices, is there a penalty, you know, besides some sort of notation?

But I think we have to be a little careful of overregulation, and particularly setting up a panel here, what if this panel were to come up with different things that conflicts with some of the things that GASB says should go into generally accepted accounting principles? It's not beyond the possibility that there could arise conflicts in the future. I just think we have to be careful of a little bit of the overregulation.

MR. BRANAN: Well, we did have --
CHAIR PARKSY: And that's why he is on the right.

MR. BRANAN: That's true.

We did have a lively discussion at the staff level over would this be an advisory panel or would it have some regulatory teeth. And we settled on advisory. I think it's more acceptable, and it's in keeping with what the general tenor of these recommendations have been, and that is to get impartial information out in the field of pensions and OPEB.

And, really, there is no single clearinghouse in the state to take up these types of questions of where does a given actuarial assumption fall.
MR. LIPPS: Don't get me wrong. I see a lot of merit in the recommendation. I just think we need to be careful about what the scope of its responsibility is to the extent that we get to that.

CHAIR PARKSY: Again, I think if you refer to page 10 of the background piece, the responsibilities could include what's listed there. And I do think that inherent in making the recommendation would be to include some recitation of the responsibilities.

MR. WALTON: Well, I think to address Lee's concern, too, I think we also ought to include -- maybe it's understood -- that it's within current -- you know, whatever the GASB or accepted actuarial practices -- it's within that confines that this body would work. They couldn't work outside of what's accepted practice within the industry today. And I'm sure John wouldn't have a problem with that.

That's understood, but it wouldn't hurt to say it.

MR. BRANAN: Well, there goes your idea of a kingdom.

CHAIR PARKSY: Well, you know, you can't have everything in the kingdom.

Jim?
MR. HARD: I just did wonder if GASB doesn't do pretty much the same thing? It doesn't, apparently.

MR. BARTEL: Yes, a big difference in that GASB -- all GASB really is doing is requiring each agency to report information in their financial statement. What we're really talking about here is a different sort of an animal.

DR. GHILARUCCI: Yes.

MR. HARD: Yes, they don't do best practices in these areas.

MR. BARTEL: Right.

CHAIR PARKSY: Teresa?

DR. GHILARUCCI: Yes, just two comments.

One: This seems to suggest that the Commission state that we want the actuary's voice to be elevated; that the actuary can actually speak first and say, "These are best practices," rather than the current practice, where the actuary is asked, "Hey, is this really wrong?," and then the actuary is there saying, "This is way out of bounds" or not. That seemed, to me, the difference between best practices and just acceptable practices.

And the second question I had is, does any other state have a functioning actuarial review board like this?

MR. BARTEL: There are a couple that have
similar sorts of things.

And I might ask Paul to confirm whether or not I have these things right.

DR. GHILARDUCCI: Is it New Jersey?

MR. BARTEL: Yes, New Jersey. There's Florida, Texas has something --

DR. GHILARDUCCI: It does, yes.

MR. BARTEL: Yes, but on the pension side.

And in a couple of those, they actually -- you need to get the board's authority to go ahead --

DR. GHILARDUCCI: Exactly, exactly.

MR. BARTEL: -- and make changes.

In other words to do something outside of bounds, the board will not let you do that.

DR. GHILARDUCCI: Right.

So this is the first -- this is really -- this would be unique among all states, that the actuarial panel would have its own voice, and would be expected to actually issue some of the best practices, as if it were the American Academy of Actuaries in California issuing reports and making judgments?

MR. BARTEL: I might even kind of describe it a little bit differently. The American Academy of Actuaries does a great job of talking about ethics and where your out-of-bounds markers are.
DR. GHILARDUCCI: Acceptable practices.

MR. BARTEL: Acceptable.

But I kind of think of best practice as maybe inside the hash marks of a football field, and that's the difference.

DR. GHILARDUCCI: Got it.

(Mr. Pringle entered the hearing room.)

CHAIR PARKSY: Any other comments on Number 5?

(No response)

CHAIR PARSKY: Okay, Tom?

DR. GHILARDUCCI: He's for it (indicating Mr. Pringle).

CHAIR PARKSY: Do you mean the man on my left? The far left, yes.

But you see when the audience is looking, it can be the opposite, too. So it's whatever you're comfortable with.

Tom, go ahead.

MR. BRANAN: "In-depth and independent review of actuarial assumptions and their forecasts are critical to all interested parties. A secondary review of financial and actuarial activities is in the best interest of the pension or OPEB fund, the plan sponsors, the taxpayers, and the active and retired employees of the plan sponsor."
Recommendation 6: "In addition to annual financial audits conducted by an outside independent financial auditor selected by plan trustees, the State Auditor should perform a complete financial audit on statewide retirement systems every three years. If a statewide retirement system administers an OPEB fund, that fund should also be included in the audit."

CHAIR PARKSY: Okay.

MR. LIPPS: Outside of the OPEB piece, how does that differ from the current practice? I understood that -- doesn't the State Auditor currently do an audit of the statewide retirement systems?

CHAIR PARKSY: Bob?

MR. WALTON: PERS currently has an annual independent auditor that they hire. They also have a separate independent actuary that reviews the actuarial process and assumptions.

The State Auditor has the authority to audit that at any point in time. They don't do it every year, but they do it occasionally.

I know, just before I retired, they were doing an audit. But it isn't done on a periodic basis, it's based on whenever requested or they feel it's needed.

So they have the authority today to audit at any point in time; they just don't do it every year or
every two years. It's periodic.

MR. BRANAN: I think the last one, before the one Bob mentioned, was in 1994. So there can be a long stretch there.

MR. LIPPS: You're talking about frequency, every three years it's recommended?

MR. BRANAN: We are. And the reason is, again, to bring in a disinterested party rather than somebody who has been hired by the system that's being audited.

CHAIR PARKSY: Matt?

MR. BARGER: I apologize, I'm going to go backwards now slightly.

CHAIR PARKSY: That's okay.

MR. BARGER: The GASB comment sort of threw me for a little while, and I was thinking about the advisory board only being within the realm of GASB.

I actually think that there are some things that are sort of best practice that might not be within the realm of GASB. I'll give an example that GASB is just silent on. Things like sensitizing the critical assumptions. It might well be best practice to say rather than just pick a point in health-care inflation assumptions, we'd like to now -- what are the implications if you look at a range of health-care inflation assumptions that might well be a best practice
that this group would want to recommend GASB would -- you
know, there's no place within GASB, I don't think, for
that kind of concept.

So I don't -- just stepping backwards, I do
want to say that only within GASB would I feel
comfortable with something that's trying to say what our
best practice is, what should people be thinking about.

MR. LIPPS: Yes, just to respond to that. When
I introduced a comment, what I said was that I saw this
as analogous to a GASB type advisory body. Not that it
would just remain within the confines of GASB, but it
would be an advisory body that would say, "Here is how
you want to do things if you want to conform with" --

MR. BARGER: Here are suggestions for best
practices?

MR. LIPPS: Right.

CHAIR PARKSY: Okay. Any comments on
Recommendation 6?

MR. HARD: Well, does CalSTRS also get audited
independently?

MR. BRANAN: They have similar arrangements
where they bring in auditors annually. But this would
also apply to them.

CHAIR PARKSY: Any concerns, Bob, about --

MR. WALTON: No. I think the difference is the
perceived independence.

CHAIR PARKSY: Right.

MR. WALTON: Now, the audit today is done independently by an outside auditor, but it's paid for by the system.

This is adding another outside auditor that's paid for by the state or someone else. And so from the public's perception, it's perceived to be even more independent because it isn't paid for by the system that's being audited.

MR. BRANAN: That's exactly what's behind the recommendation.

CHAIR PARKSY: That's right.

MR. BRANAN: It's another non-partisan check and balance.

CHAIR PARKSY: I don't see any --

MR. WALTON: I don't have a problem since they have the authority to do this today. It's merely suggesting to the state that you ought to do this more often than what you're doing it today.

CHAIR PARKSY: Exactly.

Okay, let's keep moving.

MR. BRANAN: "Funding benefit changes. In the '37 Act counties, employers have the choice of applying new retirement benefits on a prospective-only basis or on
the total-service basis," meaning, prospectively and retroactively.

"Local bargaining decides which application is chosen."

"Local CalPERS employers must apply new retirement benefits on a total-service basis," meaning both prospectively and retroactively.

Recommendation 7: "All public agencies which have the authority to determine their own pension benefits should have the flexibility to adopt pension benefit increases on a prospective basis only," and I should say, or on a total-service basis.

"How the benefit is adopted should be decided through the local bargaining process."

CHAIR PARKSY: Okay, Lee, you can start.

MR. LIPPS: Explain to me, Tom -- I understand the CalPERS requirement that it has to be offered both retroactively and prospectively. But this is going to apply to all public agencies: How is limiting an option giving them more flexibility?

MR. BRANAN: How is what?

MR. LIPPS: How is limiting an option that currently public agencies have -- right now they have the option of doing it prospectively or retroactively. This proposal which would apply to all public agencies would
limit them only to a prospective change.

MR. BRANAN: No, that's not correct.

This recommendation would give them the choice

of either prospective only or prospective and

retroactive.

MR. LIPPS: That's where I'm missing this then.

The recommendation says, "All public agencies

which have the authority to determine their own pension

benefits should have the flexibility to adopt pension

benefits increase on a prospective basis only."

MR. BRANAN: Yes.

MR. LIPPS: I don't see the retroactive.

CHAIR PARKSY: I think that will be additive to

what exists today.

MR. BRANAN: That was the intention. But

you're correct, it's not clear.

MR. LIPPS: Okay.

MR. BRANAN: And the intention is to give them

the choice of either/or.

MR. LIPPS: Okay, that's not clear from this

reading.

CHAIR PARKSY: You're right.

The lead-in was not meant to be replaced, but

this was meant to add to it. But I think we can make

that clear.
Anyone else?

Yes, Bob?

MR. WALTON: Just a comment.

From my experience at CalPERS, the reason, I think, of the current policy to apply both retroactively and prospectively is more based on being able to explain the benefit to the members and administering that benefit.

Public agencies make numerous benefit changes over the years. And if you only made it prospectively, you would have a whole bunch of pieces.

Well, this five years applies to this benefit formula, this two years applies to this final comp, this three years. So it becomes really difficult to administer because you have to take into account each one of these pieces to get a total benefit.

Also, there are certain benefit increases. We normally think of benefit increases as formula changes. Well, CalPERS has about 50 options, like using unused sick leave, various death-benefit options, which are a fixed sum.

Well, how do you apply changing from a $500 death benefit to a $2,000 death benefit, based on service?

It's not based on service, it's a fixed amount.
So I think if we're going -- and I'm not suggesting we do -- but I think if we go down this road, it has to be a little narrower to only certain types of benefits because some just aren't appropriate.

DR. GHILARDOCCI: Yes, that's a great clarification.

Tom, I just wanted to make sure I understand. You seem to be referring here more to benefit formulas.

MR. BRANAN: That's correct.

DR. GHILARDOCCI: So that's the flexibility you're going to give?

MR. BRANAN: Yes.

DR. GHILARDOCCI: Okay.

MR. HARD: Yes, I was misunderstanding this, I guess, because it did not seem like it was directed at expanding flexibility at all. So I'm happy to hear that. But I guess I'd like to see this another time.

DR. GHILARDOCCI: Yes.

CHAIR PARKSY: Oh, you mean --

MR. HARD: Edited a little bit.

CHAIR PARKSY: You will definitely have a chance to see it at another time, that's for sure.

Again, the process that we're going to go through is, this was meant to be an open discussion so staff could take away and then revise the
recommendations.

MR. HARD: Right.

CHAIR PARKSY: Then you'll see them in draft form once or twice more.

MR. HARD: That would be good.

CHAIR PARKSY: Any other?

Okay.

MR. PRINGLE: Mr. Chairman, therefore, on this, the clarification, both sides of the equation: One, in the preamble or something, state that there is the ability to have retroactive benefits or prospective benefits, and this would allow the agency to negotiate prospective benefits only.

In I think what was suggested, is to try to define then what those areas would be.

CHAIR PARKSY: Yes, right.

MR. PRINGLE: Is that what I had heard, Bob?

MR. WALTON: I think -- and someone from CalPERS can correct me -- I think today you can adopt prospective benefits but only for new hires. In other words, if it applies to current hires, it has to apply to all their service, both in the future and past service.

Again, it's from an administrative standpoint, how do you keep carving out pieces of benefits for each
person. It's very difficult to administer that, it's very difficult to explain the benefit if you have different pieces that you have to add up. It's an administrative issue that can be quite burdensome.

So I think staff may want to -- Commission staff may want to talk to CalPERS, as well as STRS, to see how this can be worked so it makes it more manageable, I guess would be the word.

MR. LIPPS: In truth, as I'm thinking about this, doesn't this recommendation only apply to CalPERS? The '37 Act counties can already do it prospectively and retroactively. Local agencies can do it prospectively and retroactively.

DR. GHILARDUCCI: Yes, I think it’s just CalPERS.

MR. LIPPS: Tom, retroactively and prospectively.

DR. GHILARDUCCI: That’s right.

MR. LIPPS: So who does this apply to but CalPERS?

DR. GHILARDUCCI: CalSTRS.

MR. BRANAN: It’s primarily CalPERS.

MR. WALTON: It applies to CalPERS and applies specifically to local government within CalPERS, because classified school and state has to be passed by statute.
And in the statute, the legislature/governor can specify whether to retroactive or prospective only.

MR. BRANAN: And in STRS, it's also a statewide --

MR. WALTON: Statewide.

DR. GHILARUCCI: So it’s just local government.

MR. WALTON: So it's local government within CalPERS.

CHAIR PARKSY: Right.

MR. PRINGLE: Mr. Chairman, it's interesting. If, in fact, it is something that's acceptable on '37 Act counties and even some locally managed health-care plans, it's somehow being -- it's operational there. So I would assume with the great expertise of CalPERS, you'd be able to figure out how that could be operational on the state board level.

MR. WALTON: I'm sure they can. In the past, their old data system was preventative in this area.

Keep in mind that CalPERS -- and it's really true for local government -- when a person works for a city or county, it's quite common for them to work for many cities and counties all under the CalPERS umbrella. And when you jump from a city that may have had two or three benefit changes to another city that has two or
three, we've got now six benefit components. And if you have it broken between prospective and retroactive, it just is very difficult.

MR. BRANAN: And I should say that within the '37 Act, it is the larger benefits that this is available for.

MR. WALTON: Sure. And that's where the large cost is.

MR. BRANAN: That's right.

CHAIR PARKSY: Okay, Tom?

MR. BRANAN: Number 8, "To avoid intergenerational cost shifting, the total cost of retroactive benefit increases should be funded over a period no longer than the average future working lifetime of the active members."

And our actuaries have told us that that period is usually 15 to 20 years.

MR. WALTON: I believe CalPERS uses 20 years now for their benefit.

DR. GHILARUCCI: 20?

MR. WALTON: I think this is a subject that really, where we're recommending an advisory panel, this is the type of thing that the advisory panel ought to be looking at.

DR. GHILARUCCI: Yes, but I think --
MR. WALTON: And it would be better left to them rather than this Commission making a recommendation on this issue.

CHAIR PARKSY: Well, maybe what we ought to do is to include this in the responsibilities of the advisory panel. That would maybe address it.

DR. GHILARDUCCI: Or decide we wanted to say it. That's what I thought we had.

I can't speak for John, but I bet he would say he wanted it.

CHAIR PARKSY: So you agree with Tom?

DR. GHILARDUCCI: Yes.

CHAIR PARKSY: So you'd like to --

DR. GHILARDUCCI: Yes, I thought that's what we had talked about when CalPERS talked about the importance of making sure that a symmetric outlook was done. You know, that if you need to treat surpluses symmetrically with liabilities. So I thought that's what we talked about in Oakland.

And then when CalPERS first told us why they changed policies, I think --

MR. WALTON: I'm not speaking for CalPERS, certainly; but I think that -- I don't think there's an issue there as long as you can look at it from an aggregate basis.
CalPERS has 1,100 to 1,200 plans -- well, employers. They have over 2,000 plans. You have some plans that have a membership of one. You have several that are two, three, four, five. So the current policy is kind of an average.

DR. GHILARDUCCI: Yes, I understand.

MR. WALTON: They don't want to do it plan by plan. And have them look at: Well, this one only has one member, and how old is he or she, and...

DR. GHILARDUCCI: Yes.

CHAIR PARKSY: I think you made a good point, Teresa. Because in one sense, this recommendation relates to you how to deal with retroactive benefit increases as a best practice --

DR. GHILARDUCCI: Yes.

CHAIR PARKSY: -- as opposed to a responsibility of the review panel.

DR. GHILARDUCCI: Right, right.

CHAIR PARKSY: So is that why you separated it out?

MR. BRANAN: That's correct.

CHAIR PARKSY: Well, Bob, how do you feel about that?

MR. WALTON: Well, still, it's an actuarial assumption that the methodology, practice, procedure,
whatever you want to characterize it as, that's being considered; and it may differ system by system.

   DR. GHILARDUCCI: Under ERISA, under the private-sector law, it does specify that past service be amortized over, you know, 30 years.

   MR. WALTON: Up to 30 years.

   DR. GHILARDUCCI: Up to 30 years. There's that recognition there, too.

   MR. WALTON: Right.

   CHAIR PARKSY: Well, I guess the question is, what would the advisory panel be considering as an alternative?

   MR. WALTON: What is the best practice as it relates to funding retroactive benefit increases and paying for those benefit increases.

   MR. BRANAN: We purposely did not add a specific number of years here, because we thought it was more a policy that should come before the Commission.

   DR. GHILARDUCCI: CalPERS is 20 or 30? Is it --

   MR. WALTON: 20.

   DR. GHILARDUCCI: It's 20?

   MR. WALTON: For that component.

   DR. GHILARDUCCI: For the back service?

   MR. HARD: Retroactive benefits?
MR. WALTON: That's correct.

DR. GHILARUDucci: And surpluses over 30 years?

MR. WALTON: It can be up to. It can be.

MR. HARD: Well, my concern is that we were putting in an actuarial specificity here of the average future working life of active members. I mean, does CalPERS calculate that on an actuarial basis when they come up with it? Or do they just use 20 years?

DR. GHILARUDucci: That's a good question.

MR. HARD: What do they do?

MR. BRANAN: I think all retirement systems calculate that, but I don't think that there is a set number of years.

MR. WALTON: My understanding is that 20 years the CalPERS established was based on an average. Some employers are more than that, some are less than that. It's an average. And that's why they chose it. They wanted a single component, so they chose an average of all the employers.

MR. BRANAN: So it could vary from retirement system to retirement system somewhat.

MR. HARD: Yes, I thought that was kind of in line with our direction on different agencies having flexibility.

So it seems like different workforces might
be -- you know, in particularly the lifetime of -- the future working lifetime of active members, that might differ from agency to agency.

MR. BRANAN: That's absolutely correct. And because of that, we just said that it should not be longer than the average future working lifetime.

And it's up then to each retirement system and their actuaries to determine that number. But we wouldn't be mandating a number.

CHAIR PARKSY: Lee?

MR. LIPPS: So Tom, just to clarify, is this intended only to apply to pension systems, not to other post-employment benefits?

MR. BRANAN: This is pension systems.

MR. LIPPS: Pension systems?

And so in the case of STRS, where the STRS board doesn't have the right to set its -- if we're not going to require this kind of funding, wouldn't that also require giving the STRS board the right to set what the contribution rates are going to be for employers and employees in a given year if there is a benefit increase? Or would it require the Legislature to adopt the actuary's recommended funding rates?

Both of those, I think, are problematic.

MR. BRANAN: Yes.
MR. LIPPS: But I'm just wondering which one you're contemplating here.

MR. BRANAN: Under current arrangements, that's not a decision that would be made by the STRS board but by the Legislature. Now, the STRS actuary could tell the Legislature what that number should be, but the Legislature moves in mysterious ways.

MR. LIPPS: But if this is a recommendation, are we also then recommending a change in how STRS rates are set? I guess that's what I'm --

MR. BRANAN: No, that's not part of this recommendation.

CHAIR PARKSY: And I think what you're saying also is, by establishing the period, with the words "no longer than," you're still giving plenty of flexibility to adjustments, what the numbers should be; right?

MR. BRANAN: That's correct.

CHAIR PARKSY: Well, I think, for now, why don't we maybe leave it as a recommendation; but we may want to adjust it to be part of the panel issue. I think it is different under the heading of how you're going to fund and make the public aware of the funding of benefit changes.

Okay, go ahead.

MR. BRANAN: "Funding benefit changes. The
cost of pension or OPEB benefit changes ultimately
depends on the level of benefits which will be paid to
members over time."

"Plan funding policies determine the immediate
impact on contributions and how any change in
contributions will be spread over future years." 

"On occasion, some retirement boards have
conditioned changes to their funding policy on plan
design actions by either the Governor, the Legislature,
or employer agencies."

A case of this was when the governor,
Deukmejian, signed the one-year final compensation bill
for state workers in exchange for the PERS board giving
them more flexibility on the state PERS contribution.
We talked about the PERS board and benefit enhancements
in the nineteen-nineties and the City of San Diego. In
all of those, there was some level of quid pro quo.

The draft recommendations: "There have been
times when some public retirement systems" -- and I think
as Commissioner Walton has said, not just the systems,
but the employers as well -- "have manipulated aspects of
their funding policy to encourage employers to grant
benefit increase."

Number 9 draft recommendation, "Benefit
improvements by the employer should not be contingent
upon the actions of the retirement board."

CHAIR PARKSY: Comments here?

Bob?

MR. WALTON: The only comment I have -- and I do support this, I've brought it up before -- but in your background information, I think you may have given the carrot and the stick to the wrong people. I think it's the actions by the employer that cause the retirement board, in some cases, to take action, and sometimes it's the reverse.

In the case of the one-year final comp, it was the employer, the state, the State Legislature, that said, "You'll get one-year final comp only if the CalPERS board does certain things," as opposed to the converse. So both sides are guilty of acts in that regard. It's not one-sided.

MR. BRANAN: Well, would that require a change in the wording?

MR. WALTON: Only in the background.

CHAIR PARKSY: Just the background.

MR. WALTON: Just the background.

CHAIR PARKSY: The recommendation seems pretty clear.

MR. PRINGLE: It does. But I don't understand how it's enforceable, applicable, effective in any way.
And this verbiage, as a stand-alone sentence of
the recommendation, it sounds kind of goofy to me. You
know, if the Legislature says you can do this and passes
legislation and the PERS board takes action, how does --
I mean, I don't -- I would like to have it clearer in
terms of what we're trying to get at.

This sentence makes it sound to me as if, you
know, maybe it happens more in a '37 Act County -- or
maybe I'm improperly referencing that at all -- but where
you do have a lot of local influence where a retirement
board serves a singular purpose, therefore, they're able
to deem -- there are more resources available over a
period of time. And with that understanding, "Okay, now
we can afford that benefit."

I see where, from my interest, that is what I
would like to make sure this sentence means, if we can;
but I have a hard time adding up all of those background
comments to get to this sentence from legislative action
that changed -- to move to the one-year highest pay as a
retirement benefit than PERS taking the action to
San Diego and the others.

I don't necessarily see this as answering
those.

I mean, I understand what this sentence is
about; I don't necessarily see how it applies to the
background information as such, nor do I really see it
going to the point that -- well, maybe I don't even see
the points that we're trying to get to.

    I see this one sentence as kind of a simplistic
response to maybe '37 Act counties that may have undue
influence of the decision-makers over their retirement
boards, but not necessarily how it might apply to
CalPERS.

    CHAIR PARKSY: Well, in one sense, the lead-in
here, Tom, would suggest that retirement systems have
acted in a way that is meant to, in your words,
manipulate the funding policy in order to encourage
benefit changes from the employer.

    And what you're -- but the recommendation isn't
clearly linked to that introduction. You then start from
the opposite, that the employer shouldn't make any
benefit increases contingent on the board acting.

    So in one introduction, you kind of come at it
from one side, and then in the recommendation from
another.

    Is that intended?

    MR. BRANAN: That's not intended.

    Originally, we had two mirror sentences here.
That the employer -- actions of the employer should not
be contingent on actions of the retirement board; and
then the same thing, that the actions of the retirement
board should not be contingent on those of the employer.

But we thought that those two taken together
sounded kind of goofy.

CHAIR PARKSY: Well, you've succeeded in
convincing the mayor that the entire page sounds goofy.

So is it your intent to suggest that both sides
of this equation should be addressed here in this?

MR. BRANAN: Absolutely. This is something
that both parties enter into. No matter which one
initiates it, the other party has to play the game.

And while it certainly has happened in the
'37 Act, I would say the most egregious examples are more
at the state level.

MR. WALTON: One other comment --

MR. HARD: I do, too.

CHAIR PARKSY: Would you put that into the
category of hurting credibility, or this is a practice
that -- what you're trying to do is to have each of these
two bodies be able to, quote, act independently of the
other, for whatever they have authority to do?

MR. BRANAN: Well, certainly they should act
largely independent of each other, if not entirely.

And as far as credibility, I think that's been
a real casualty in this kind of collusion, that costs and
costing periods can be manipulated. The level of assets supposedly on account can be manipulated all in order to get, say, a new benefit offered to the members of the system.

CHAIR PARKSY: But I guess the question inherent in that is, are these kinds of statements really to get at that, as opposed to policies that would address the manipulation of the kind of information you're talking about.

I think in one sense, Curt is really right. I mean, inherent in saying "each of the bodies should act on their own" doesn't really address -- what you're saying is, underneath all this, there is some element of collusion.

I mean, if one part doesn’t want to take certain action, the other part may kind of move the data around to get that action to happen. That's really what you're addressing here?

MR. BRANAN: That's correct. Would the second sentence that I described close this loop?

DR. GHILARUCCI: No. I think it’s the structure.

MR. HARD: I think that Curt made me wonder -- I don't think the manipulation of the actuarial assumptions is a healthy thing, probably, for the fund
or transparency or public confidence. But what Curt made me think as well that the fund, actually -- the circumstances of the fund actually change, these statements -- do these statements take into consideration actual, legitimate changes in which the fund changes so that the employer might want to negotiate something different? Because I don't see the way the recommendation is written making any distinction between actual, legitimate recognition of fund changes versus manipulation.

Do you think it does?

MR. BRANAN: Yes, I think it does. It may not be worded correctly. But it sounds like what you're talking about is a retirement system becomes better funded over time.

MR. HARD: Perhaps. It could be worse, too.

MR. BRANAN: Yes. But let's say it gets better.

MR. HARD: Right.

DR. GHILARDUCCI: They make good decisions.

MR. BRANAN: And then the employer having more money on account may feel that they can grant a new benefit. That's entirely different than the retirement board saying, "If you grant a new benefit, we are going to artificially inflate your assets on account by 5 or
10 percent."

MR. HARD: Absolutely. And I understand that. And I don't think that's a very good policy. But I'm just wondering if our recommendation is clear on that distinction? Because "The benefit improvements by the employer should not be contingent upon actions of the retirement board." Well, that doesn't mean that the action of the retirement board was a manipulation rather than a legitimate action of the board.

MR. BRANAN: Well, if they -- and this is --

MR. HARD: I have no disagreement with where you're trying to go or --

MR. BRANAN: It just seems to me that if a retirement system, through its investments, becomes better-funded, the employer's action is not contingent on --

DR. GHILAR DUCCI: It is.

MR. BRANAN: That's not an inappropriate behavior by the retirement board.

MR. HARD: Right.

MR. BRANAN: But that's also not what we've been talking about.

MR. HARD: No, I know it's not what we've been talking about. But I'm just wondering if the recommendation makes the distinction. And just for me,
it doesn't.

MR. BRANAN: Okay.

MR. HARD: But I know what you're talking about. I agree with where you're going.

CHAIR PARKSY: Well, maybe what you need to do is to think about somewhere in this report, there should be a way to address manipulation of aspects of funding policy. That's one thing. And then separate from that idea is the notion that there should be a somewhat requirement for an independent review on the part of the employer of any information that's being provided, that would result in a benefit increase.

I just -- I think what you're hearing is, these two sentences don't seem to say what you want and, therefore, in the words of our august mayor, look goofy.

MR. BRANAN: Well, we can't have that.

CHAIR PARKSY: Bob?

MR. WALTON: A couple observations, thinking about this a little further.

This recommendation deals with benefit improvements. And I assume you're talking about retirement benefit improvements.

MR. BRANAN: Yes.

MR. WALTON: As I recall, I believe it was about 1981, it was the first year that the state had
adopted -- were asked to adopt negotiated MOUs with state
bargaining units. And I think it was 1981. The
Legislature, in their wisdom, had to fund those MOUs.
And in doing so, they added language in law that said,
"We'll only fund these MOUs" -- and they didn't have
 anything to do with retirement benefits. They had salary
increases and other things. But the Legislature said,
"We'll only fund these if the CalPERS board reduces the
state contribution to the retirement system by the cost
of these other things."

Well, that had nothing to do with the
retirement benefits, but that was a clear quid pro quo.

CHAIR PARKSY: Correct.

MR. WALTON: So it's beyond just retirement
benefit improvements.

On the other time, in 1991, when the one-year
final comp, which was used as an example here, the State
wanted to go from a monthly to a quarterly payment. And
in exchange for that, they offered a one-year final comp.
Now, there was other moving parts to that, but, in
essence, those were the two primary issues, as I recall.
And that was adopted.

Then later, the State Legislature/Governor
unilaterally extended the payment schedule from quarterly
to semi-annually, and eventually to annually, one-year
paying in arrears. Now, that was litigated. And in the court finding, the question was, where should they move back to? Should they go all the way back to monthly? And as I recall the court ruling, their words were, in effect, "No, they only have to go back to quarterly." Because in going from monthly to quarterly, that was arguably a take-away from the members. That arguably the system wasn't as well-funded on an ongoing basis as it was when they made monthly payments. But they got a benefit improvement for that, so it balanced it.

Under law, you can't take away a retirement benefit unless you give something of equal or greater value in return. And the court said it was of equal or greater value.

So here, you had to have a case where you had to have the quid pro quo, or both sides wouldn't have gotten what their ultimate objective was. So I don't know how you address that in a statement like this.

I think we all know what we'd like to see, it's just going to be very difficult to define in the words, I think.

CHAIR PARKSY: Matt?

MR. BARGER: In reading these examples, they're all based around actuarial assumptions that were changed. Here, you're being asked to change the actuarial value of
the assets or, you know, they all revolve around that, to
just say --

MR. BRANAN: I think the payment schedule in
the City of San Diego was involved in that one. Changing
the payment schedule for a benefit increase.

MR. BARGER: Because I would draw a distinction
between the two, honestly. One is, you know, you're
changing -- and it gets to the credibility and the
transparency -- you're just changing what is supposed to
be sort of to be assumed to determine the calculations
for political reasons. But that bothers me a lot more
than, honestly, the state determining that, you know, it
doesn't have enough money this year and it's going to
change the law and the city or whatever, that that's what
it's going to do. I don't think that's so great, either;
but I don't think it's as corrupt as the first one.

CHAIR PARKSY: So you'll take a shot at
changing that around?

MR. BRANAN: Yes.

CHAIR PARKSY: Okay, before we break here, I
just wanted to come back -- Matt raised a couple of
issues in previous discussions; and I just want to see,
Tom, how we can -- where we might consider addressing
those.

Are you familiar with what Matt had raised
about the disclosure of liabilities using financial as well as actuarial discount rates?

MR. BRANAN: Yes, I am.

CHAIR PARKSY: Where would you recommend that issue be addressed?

MR. BARGER: Discussed.

CHAIR PARKSY: Or discussed.

MR. BRANAN: I think we should do that at the next hearing. That way, we'll have time -- rather, that will still give us time to get a reaction and see if the Commission wants to come up with something in writing.

MR. BARGER: And just to be clear on what it is that I'm suggesting, I'm not suggesting that financial valuations replace actuarial valuations. It's similar to my comment about analysis of sensitizing health-care inflation.

I think looking at these things more than one way, to my way of thinking, is appropriate and, you know, whether or not it falls within the purview of an advisory committee on actuarial standards or what, but just some sort of best practice that there's probably more than one way to evaluate these things.

MR. BRANAN: That's something like the New York model?

MR. BARGER: Yes, like the New York City model.
CHAIR PARKSY: And, Matt, I had interpreted that question or comment to be just that, that it would be additive.

MR. BRANAN: Yes.

CHAIR PARKSY: It's not replacing anything. In the New York City model, it is additive; is that --

MR. BRANAN: That's correct.

CHAIR PARKSY: Well, I don't see -- I mean, I think we should discuss it and maybe put something forward that would be in the form of a recommendation. But it seems to me that it's something that we ought to really think about including.

MR. BRANAN: We'll have that ready for the next hearing.

CHAIR PARKSY: Okay.

Matt, is there anything else that you had on -- I know that we're going to talk a little bit about composition of retirement boards.

MR. BARGER: The qualifications, yes.

CHAIR PARKSY: That will come up this afternoon.

MR. BARGER: Actually, I don't have my e-mail in front of me. But did we cover the other one? I can't remember what the other one was.
MR. BRANAN: You and I spoke about it this morning.

MR. BARGER: Yes.

CHAIR PARKSY: All right, if that -- I think that we can take a 30-minute break now for lunch and then come back and address the items that are listed afterwards.

Thank you.

(Midday recess taken from 12:12 p.m. to 1:00 p.m.)

CHAIR PARKSY: We can begin our afternoon session.

Tom, are you ready for us, or are we ready for you?

MR. BRANAN: That remains to be seen, Mr. Chair.

CHAIR PARKSY: Well, you were definitely a challenge this morning. We'll see what happens this afternoon.

MR. BRANAN: The sun is out.

DR. GHILARUCCI: Spiking is easy.

CHAIR PARKSY: And hopefully we can get through these recommendations.

I do want to come back and make sure the Commissioners -- we clarify a little bit of the
statistical information relating to the prefunding issue, which was a little bit confusing in the last meeting, and so I'd ask the staff to be ready to clarify that.

DR. GHILARUCCI: That's right.

MR. BARGER: Gerry, didn't we skip over also the question about medical?

CHAIR PARKSY: Yes. There is one area that we need to come back on. And I didn't have it in mind here; but if we have time, we can come back to that. Or I know you had it on either the next meeting or the last meeting.

I think I'd like to save the last meeting some extra time. So we'll get it in next time, if we don't have it here. That's the one item we didn't cover in the last agenda.

MR. BRANAN: Oh, cost containment? Yes, that's on at the next hearing.

CHAIR PARKSY: At the next hearing? Okay. Let's move ahead with the next item.

MR. BRANAN: The next item is pension spiking.

CHAIR PARKSY: Well, it's an overall heading; right? I mean, we were going to have actions which hurt the retirement system credibility; is that --

MR. BRANAN: That's correct.

CHAIR PARKSY: It under that category?
MR. BRANAN: And under that category was spiking and disability abuse or fraud.

CHAIR PARKSY: Okay.

MR. BRANAN: For spiking, spiking is generally seen as the intentional inflation of final compensation so as to increase the retirement benefit. And I might add, that's almost always done without proper funding.

"It is easier and more effective to spike final compensation when the final compensation period used to calculate a pension is shorter rather than longer."

"Responses from the Los Angeles County Employees' Retirement Association or system, CalSTRS" -- we have two CalSTRS - “and CalPERS, to the ‘Thirty Ways to Spike Your Pension' document provide examples of symptomatic procedures adopted by the major retirement systems to control spiking."

And I should say that that document, "Thirty Ways to Spike Your Pension," was handed out at a previous hearing by Ted Costa, who was representing a group known as People’s Advocate.

Finally, "Spiking, while not eliminated completely, is now a less serious problem than it was earlier.

Spiking recommendations: "Since spiking most often takes place shortly before retirement, the inflated
benefit which spiking produces is usually unfunded. Historically, it's been primarily a management abuse."

Number 10, "Retirement systems and public agencies should be open and transparent concerning what elements are included in final compensation for management."

CHAIR PARKSY: Okay, comments?
You like it?
MR. LIPPS: Yes, I do.
CHAIR PARKSY: That's good.
And do you think it's properly -- there was a comment about how we position this issue, not just out there, but within this overall category of what hurts credibility, which is, I think, important that the Commission, to the extent that we're aware of things, highlight.

So no objections? Comments?
Yes, Mr. Mayor?
MR. PRINGLE: Well, I guess I'm having a hard time understanding what we're recommending. We're recommending that the retirement systems and public agencies hold open and transparent benefit formulas or retirement structures?

I mean, under the definition of the word "recommendation," I would say we're asking -- we're
suggestion something should be done; and I guess I don't see what we're asking should be done.

CHAIR PARKSY: Well, again, I think you have to start with at least what is being suggested as -- although there's no hard and fast definition of "spiking" -- that the underlying concept here is final compensation is at the heart of where, quote, "spiking" comes into play.

And I think Tom or the staff was suggesting that the way to address this, quote, “abuse,” is to make sure that there is a clear recitation of all the elements that are in compensation.

Is that where you're coming from?

MR. BRANAN: That's correct. And I think you have to appreciate the history of this problem.

Spiking used to be a very serious problem. And the way it was usually done was by hiding elements that, at the last minute, went into final compensation.

So we kind of have a recommendation that does come after the fact where the retirement systems have dealt with spiking and have -- it will never go away.

Humans are very creative.

But it has been greatly reduced. And the retirement systems have systematic procedures in place to catch it.
And so what we are really --

MR. PRINGLE: Are we -- some of those are articulated, I guess, in the fuller draft; right?

MR. BRANAN: That's correct.

MR. PRINGLE: I just would like to offer a suggestion, that some of those that have been adopted -- I mean, why would we not suggest those are best practices for openness and transparency for retirement systems to guard against abuses or something, so that at least there is something here?

I just view at some point in time people will pull all our recommendations out and say, "Okay, what are the recommendations of this Commission."

And this one, on an issue that is contentious and public and out there, without demonstrating any meat behind the bone, I think it might just look hollow. And I think what you're suggesting is, there's a lot of things that have already taken place. Maybe we mention in one sentence what some of those have been as examples of openness and transparency that have eliminated that by many, the potential for improper spiking of a pension.

MR. BRANAN: We could do that easily. There are several good examples.

MR. PRINGLE: Okay.

CHAIR PARKSY: Bob?
MR. WALTON: I think, Tom, correct me if I'm wrong, but -- we're just talking about Recommendation Number 10 now?

CHAIR PARKSY: Right.

MR. WALTON: A recent example took place here in the City of Sacramento, well-publicized. And the City, they gave a pay increase to their chief of police. And they reported that because the chief was only going to be on employment for a short length of time, while it was a big increase on an annual pay level, it was only going to, quote, cost the City like $8,000 because he was only going to be here for this period of time; where, in fact, because that increased his final compensation for retirement purposes, the cost to the City is going to be substantially more than that. And reporting that substantial cost to the City is being more transparent. That's the sort of thing that you're talking about here.

MR. BRANAN: That's correct. And had this happened, say, before 1994, it may well have gone unnoticed. But in this case, that person is a member of PERS. And PERS has both a computer system and a human manual check, both of which would catch this.

MR. PRINGLE: Excuse me, if I may, Mr. Chairman.

It catches that unusual increase in final
compensation, and it stops it?

MR. BRANAN: I think it's worth noting, I specifically asked PERS, STRS, and LACERA, when you do catch this, are you authorized to deny them? And all three have the statutory authority, and report that they regularly do deny things that don't fall within their acceptable practices.

MR. PRINGLE: Therefore, under this, Mr. Chairman, I would like that to be a recommendation, that that is a best practice, that is something that needs to be in place for all retirement systems. And if it is particularly on those large three, shouldn't others -- we don't know if it is on others. And it may be of value to specifically point that out, particularly for the public who is going to be looking at this, and looking at this section to see if those issues have been addressed.

CHAIR PARKSY: Is that -- Paul?

MR. CAPPITELLI: Just a question. And it's addressed here in your supporting documentation, but just for clarity: There were a number of items that were identified on the list that was presented to us that are, in fact, considered as part of case law or other decisions, they are considered in somebody's final compensation. And it's not an abusive practice, it's
something by which they are entitled to, either through collective bargaining or through the court process or otherwise; correct?

MR. BRANAN: That's correct.

MR. CAPPITELLI: So will that be embedded in our final report, too, or do we need to call attention to that somehow?

MR. BRANAN: Both in this background material and then in an appendix that will be in the final report, that point is made.

As I noted in here, more than PERS or STRS or any of the independent systems, the '37 Act system's guidelines for what is acceptable for reporting as final comp has been set out by the courts.

For PERS and STRS there have been court cases, but primarily, it's been set out by the Legislature.

But they all -- now, those two processes have come up, in some cases, with different items, some that are acceptable in one system and not in another. But it is systematic within the systems.

MR. CAPPITELLI: Thank you.

CHAIR PARKSY: Do you think you have enough guidance here now?

I do think the way the recommendation reads now, people wouldn't naturally link it to what you're
MR. BRANAN: We have some very good examples that I'll include there.

CHAIR PARKSY: Okay, all right, keep going.

MR. BRANAN: "During current bargaining between the State and its employees, almost all bargaining units which have settled, have approved a return to a three-year final compensation from a one-year final compensation period."

Recommendation 11: "The three-year final compensation period recently bargained at the state level seems to be a best practice for discouraging pension spiking. When local agencies with a one-year final compensation period are engaged in the collective bargaining process, the Commission recommends that they bargain a return to a three-year final compensation period.

CHAIR PARKSY: Okay, yes, Jim?

MR. HARD: Well, you were starting on the right. We can start right here?

CHAIR PARKSY: I can start wherever you like.

MR. HARD: I'd like you to start right here.

CHAIR PARKSY: That's okay.

MR. HARD: My experience over the last 32 years in public service doesn't give me any insight into the...
vast majority of public employees having any spiking of
their -- in the rank and file out of management of their
pensions whatsoever. I don't know anybody that it's ever
happened to, and I certainly don't -- this last thing, of
moving from one year to three years was negotiated, and
it was negotiated in a complex negotiation with a lot of
other factors involved.

And, frankly, I read your background material,
and somebody from state management told somebody at
CalPERS that that was about spiking, and that it was
about a public perception. But my recollection -- and I
was involved in some of that -- is spiking was never,
ever an issue in what I heard at the bargaining table.
It was not an issue at all, ever. It was a matter of
saving the state money.

Pay raises for a hundred thousand employees has
nothing to do with their final compensation. They may be
in their second year of employment, they may be in their
32nd year of employment.

You know, I don't -- I know in your background
also it says something about this has occurred in
bargaining units; and I don't challenge that at all. I'm
curious to hear about it because I'm unaware of it. It
may well have happened, I don't know. Not in my
experience, though.
So I'm completely opposed to this. This is -- it isn't necessarily any kind of best practice, particularly when I don't see any evidence that it happens with rank-and-file workers.

If it happens with management people -- which I've read in the newspapers enough to know it happens -- that's one thing. But I don't understand how the negotiation of the calculation of the final compensation for purposes of retirement could be considered spiking when you have a hundred thousand people. You are negotiating for six months of -- one month of employment to who-knows-how-many years. So I don't think this is a very appropriate recommendation from this Commission to direct people how to do their collective bargaining across the state.

CHAIR PARKSY: Well, I guess the real question is, does the Commission want to address this one-year versus three-year; not necessarily indicating that there is, quote, "spiking" going on anywhere. But is it a practice that, among other things, would certainly be a buffer, if you will, toward any spiking at any level that may occur?

MR. HARD: Well, I guess it might, except for I just heard an example of a one-month spike in Sacramento that appeared to be, like, $8,000, and has
much bigger ramifications. And that's less than a year.

So I don't know where this would go in the end, but it doesn't sound like a place that I think we should go.

CHAIR PARKSY: Yes?

MR. CAPPITELLI: I think Commissioner Walton really summed it up. Maybe this issue is not best-addressed here. It speaks to the broader issue, which has to do with the future liability that could be considered unfunded, as opposed to it being a spiking issue. I'm talking one-year versus three-year.

And if perhaps that would make it more palatable, we could address it there. But I think maybe that's the bigger issue here as opposed to where it belongs to.

CHAIR PARKSY: Do you mean, keep the recommendation --

MR. CAPPITELLI: Yes.

CHAIR PARKSY: -- but not have it suggested as part of a spiking abuse issue?

MR. CAPPITELLI: Yes, because, you know, spiking -- if you go -- if you look at what it is we're trying to get to the root of here, when you're talking about spiking, we're talking about something that has to do with something that appears to be a gift or something
that's granted at the eleventh hour, for which there's no
future funding to back it up or to support it, which
means that somebody has to pay for it out of the system
somewhere. So maybe it's more palatable if the
recommendation lies somewhere else within the report, but
not here.

CHAIR PARKSY: Lee? I know you were poised.

So go ahead.

MR. LIPPS: For the record, I'm -- forgetting
the issue of spiking, I don't think it should be linked
to spiking whatsoever. Even to imply that somehow
final-year compensation provisions encourage spiking in
some fashion, I find problematic. But for the record,
I'm opposed to moving away from what the current
final-year compensation provisions are in various
agencies.

It seems to me entirely appropriate --
particularly when we're talking about the employee ranks,
particularly where many of them in this state are subject
to collective bargaining agreements, you're not going to
get a significantly large increase in any particular year
that is going to jump up somebody's pension more than 2,
3, 4 percent. Just mathematically, it just doesn't work.

I don't see any need for this whatsoever.

CHAIR PARKSY: Well, again, taken outside the
context of spiking --

MR. LIPPS: I am.

CHAIR PARSKY: -- then the question is, is it sound policy or not?

MR. LIPPS: No, I don't believe it is.

CHAIR PARKSY: Bob?

MR. WALTON: Yes, I was probably troubled by this recommendation more than any other. I think it would be symbolic, at best, it's no different than this Commission recommending changes in retirement formulas or anything else.

I think fundamentally the consensus has been, at least that I've heard, that your retirement benefits are part of your total compensation, and it's up to the local government and their respective employee organization to decide how best to compensate. If their decision is to base retirement on one-year final comp, that ought to be their option.

I think if you want to address spiking -- which I think is a problem -- this isn't the way to do it. There's better ways to address spiking. For instance -- and I'm not suggesting this, but just as an option -- you simply limit how much your compensation goes up during your final-comp period to a set percentage.

There's other states that have done that. It
eliminates spiking all together, whether it's one-year --
you can have spiking with three-year final comp. It just
lessens the effect of it, but you can have it.

So it really doesn’t address it, only from a
public-perception perspective only. So if we want to
address spiking, which I think we should, I think this is
not the right way to do it.

CHAIR PARKSY: Teresa?

DR. GHILARUCCI: The reason why ERISA and
most personnel best practices discouraged one-year
compensation, is actually to prevent employers from
artificially lowering the wage of an older worker right
before they retired. It was mainly to prevent the abuses
on the employer's side to demote or lower the hours, so
that you had an artificially low salary before you
retired.

And it also seems that the consensus is that
it's distortionary to have your benefit only rely on your
last year's salary, when the pension is supposed to
reflect your buying power and your standard of living
throughout your life.

So I think it's a bad idea to have one-year
comp. I can't think of a situation -- that doesn't mean
there isn't, but I can't think of a situation where it's
ever a good policy to have it on one-year comp because it
encourages all sorts of distortionary behavior, both on
the employer and employee's side.

However, whether or not we should go so far as
to say what the benefit formula should look like seems to
be beyond what we would do here.

CHAIR PARKSY: Well, but consistent with what
you were just saying, though, you would make a
recommendation that highlighted the inappropriateness of
one-year?

DR. GHILARDUCCI: Yes, for all sorts of
unforeseen consequences, that it could be distortionary.
And one of them could be spiking, but it could also
encourage bad behavior on the employer's side.

CHAIR PARKSY: Bob?

MR. WALTON: Just a point of reference, that in
California -- I know CalPERS as well as '37 Act, while
it's commonly called “final compensation,” your benefit
is based on your highest consecutive 12 or 36 months. It
can be any, 12 or 36 months. Whether it's your final one
or not is irrelevant. It usually is, but it doesn’t have
to be.

CHAIR PARKSY: Usually it's the highest?

MR. WALTON: It's the highest consecutive 12-
or 36-month period, depending on whether you're under
one-year or three-year.
MR. HARD: Which eliminates the management.

MR. WALTON: It can be any period, as long as it's consecutive.

DR. GHILARDUCCI: But it doesn’t have any bite.

MR. WALTON: See, I think a policy from this Commission that went to more -- a broader concept of to discourage practices that inflate pensions, whatever that may be, without mentioning one-year, but there's many others that can do it.

DR. GHILARDUCCI: And one of them would be this CalPERS review which discourages it. It’s a case-by-case --

MR. WALTON: Well, that's to uncover it. But to do something in a nature that unjustly rewards through retirement a person's compensation or something as -- it's very difficult to find the wording for it, but I'm sure staff could take the task if we want to go that direction.

CHAIR PARKSY: It seems that there are kind of two concepts. One concept is to shine a light on, or disclosure of what compensation by definition is.

MR. WALTON: Correct.

CHAIR PARKSY: And that is inherent in some of the changes you'll make in Recommendation 10.

Then the only question is, do we want to go
farther than that and indicate something more specific with respect to these calculations.

And I gather that this Commission is not inclined in that direction other than people wouldn't want to indicate that the one-year is something that ought to be reconsidered or -- make a statement about one-year?

MR. WALTON: I'm opposed to the one-year. But I think a statement about compensation practices that unduly reward those that are ready to retire -- for instance, I didn't want to get into this detail, but I know one public agency under CalPERS has 120 different forms of special compensation. I know an agency in CalPERS that has a special comp called "bell-ringing pay." And that every hour they ring the bell and they get a special comp for that purpose, that's reportable under the law in CalPERS; and they assign that duty to the senior-most person in order to increase their retirement.

Now, that has nothing to do with --

MR. PRINGLE: Is it a physical bell?

MR. WALTON: What's that?

MR. PRINGLE: Is it a physical bell?

MR. WALTON: It's a physical bell.

DR. GHILARDDUCCI: What?
MR. WALTON: It’s a physical clock that they wind that they get clock-winding pay. Those are the types of things that you ought to be concerned about.

MR. PRINGLE: I think someone could add 32 ways to --

DR. GHILARDUCCI: Yes, 32.

CHAIR PARKSY: Tom, do you have a comment?

MR. BRANAN: Well, it sounds like what the Commission would be more comfortable with is expanding Number 10 --

CHAIR PARKSY: Right.

MR. BRANAN: -- to talk about, in some partially, more general concepts of spiking; and then also specific points that can be made showing how retirement systems have taken it upon themselves to identify the items that should not be reported and to deny them. Because, really, that's the point that we wanted to make. Spiking was a very significant problem leading up to the early nineteen nineties.

It will always go on, but the magnitude of it has really dropped due to these kinds of actions by this retirement system.

CHAIR PARKSY: The actions taken.

MR. HARD: Can I ask a question?

MR. BRANAN: Yes.
MR. HARD: Bob was reminding me that it's really not your last 12 months; it's the 12 months of highest compensation. It could have been five years ago.

Is that the case in the local agencies, cities, counties? Is that the same?

MR. BRANAN: For --

MR. HARD: Is that the same rule of --

MR. BRANAN: Yes, I believe it is.

MR. HARD: -- either 12 or 36 months?

MR. BRANAN: Yes.

MR. HARD: So it's not really the last 12 months, anyway?

MR. BRANAN: It's not -- it's just a term that's used, “final comp.”

MR. HARD: Right.

MR. BRANAN: But it doesn't have to be -- it often is your final compensation because you're at the end of your career, but it doesn't have to be.

MR. HARD: Right. And normally, it probably would be.

I don't want to go too far down this road; but, I mean, the fact of the matter is, if you're going to talk about the number of years and all that, you could also talk about the negotiated general salary increase that employees, through their bargaining process, might
achieve. I mean, that will change their retirement if they stick around and that happens to be their highest year. So I just think it's not the right road to go down.

MR. BRANAN: I think that I get that is the sense of the Commission; and we will not pursue Recommendation 11.

CHAIR PARKSY: Okay.

Yes, Matt?

MR. BARGER: Actually, I didn't have a chance to look at these before, but I'm sure in paging through the responses of LACERA and PERS in terms of specific actions they've taken to address the things -- that they can address. Some of this is court actions and saying, "I'm sorry, you do have to count that." I wonder, rather than just that bald statement about is ten -- whether or not more exhaustive commentary about actions that are taken and examples of best practice or something to make that a little beefier. Because I don't think it really matters whether or not there's more or less going on than ten years ago. I think all you really need are a couple of headlines like this and some stories like Bob's to just cast doubt about the credibility of the system. I think, you know, coming out firmly and strongly with a fair amount of detail about, "We're against this, here
are things that are being done that we recommend as best practices," et cetera.

MR. BRANAN: I think that's the direction we've gotten.

CHAIR PARKSY: I think that's where you should go here.

MR. BRANAN: And I would point out one difference. In the case that Mr. Walton brought up, had this come out 20 years ago, there would have been no remedy for it because there were no real guidelines. Whereas now, even though it does get the press, also in some of these reports, it's been brought up that just because he got that doesn't mean it's going to show up in his pension; that that's a decision PERS makes. So things have changed.

MR. BARGER: Although that's only true for PERS; correct?

MR. BRANAN: No, that's true for STRS, the teacher's retirement, and the '37 Act as well.

MR. PRINGLE: Mr. Chairman?

CHAIR PARKSY: Yes?

MR. PRINGLE: One point. I guess I thankfully am not in Sacramento enough anymore to regularly read The Sacramento Bee. But, in fact --

CHAIR PARKSY: Except when you are in
Sacramento?

MR. PRINGLE: Of course, I would read it when I'm up here.

But just a question. I guess I don't understand the whole -- even the police chief's example. That would be his 12 months' highest compensation under a CalPERS model. Therefore, how would one month worth of that have, as you all had suggested, a dramatic effect on his overall retirement benefit?

I'm just trying to see if there's --

MR. WALTON: It increases his, quote, unquote, "final comp," depending on how long he's paid that amount.

Keep in mind, there's other moving parts. Let's assume the person in question has six months' worth of vacation pay. Well, that higher salary now is applied to vacation pay. And while they may physically end today, they don't retire for six more months. And that pay at the higher range is reported for that six months.

So there's other moving parts here that affect the person's, quote, unquote, retirement.

MR. PRINGLE: But in this case, was there any three-year averaging retirement on --

MR. WALTON: I think there's one year for the City of Sacramento, if I'm not mistaken. Somebody can
correct me if I'm wrong.

There's other ways to do it. This is just one example.

Public agencies, especially at the management level, have the ability to reward sick-leave credit to their managers. While under the retirement law, an agency can contract to give retirement benefits for unused sick leave. Well, you simply give a person more sick-leave credit before they retire, and all of a sudden that's converted to a retirement benefit.

MR. PRINGLE: In all of this level of discussion, it is interesting, but much of these are management-level employees that would have -- I mean, the difference between our bargained employees and management employees, there is probably a different way in which some of that could be applied.

I could understand maybe someone working in a public-safety position where you did have great access to overtime and other things like that; but that's self-inspired additional work to boost your --

MR. WALTON: Well, overtime isn't included in those.

MR. PRINGLE: Oh, is that right?

MR. WALTON: It's not.

MR. PRINGLE: So in terms of many of these
examples, what would you say the percentage would be in terms of management employees versus non-management employees?

MR. WALTON: My experience is the vast majority are management employees outside the bargaining process.

MR. PRINGLE: Well, see, I think, Mr. Chairman, there is a way to get something like this, and maybe even something stronger without stepping on the toes of bargaining units that feel that they have a right to have these discussions. Because I think we should separate the two issues and say, you know, many of these issues are bargainable issues if you're a bargaining employee. But in the cases of management employees, where spiking has been historically defined as a greater problem, these types of things -- local agencies, state agencies, should not allow these types of things to take place, and there should be a greater averaging over a longer period of time of the definition of "final compensation."

I think we should say something like that without, again, making it look like we're trying to interrupt the collective bargaining process. Because I, too, often think it's awfully hard for a collectively bargained employment position to overstep too many of these bounds, yet we see how easy some of that could
occur in a separate management spot where two or three people can set your salary -- or one person -- a city manager could set the salary of every department head. And if there are two or three of those department heads choosing to retire that year, they could be overly augmented through that salary system and create that spiking level.

I do think there may be value in separating this.

CHAIR PARKSY: Well, maybe, again, you can include in this recommendation -- or recommendations -- the acknowledgment of distinction between management and others, and in addressing the ways in which abuses have been dealt with include the notion of a longer period for measuring final compensation.

If it has been adopted, it would show up on your list of things that have been adopted.

MR. BRANAN: Yes, that would be good.

MR. CAPPITELLI: Should we define the term "spiking"?

MR. BRANAN: Well, that's -- I think the working definition that LACERA, STRS, and PERS have is -- and it's not precise -- but it is an increase in final compensation for the primary reason of increasing the pension, okay.
Now, and what they look at, is this thing part of a systematic program? Like, bonuses are acceptable, but they have to be part of a well-defined, described-on-paper bonus system. And it can't be that, in reality, the only people that get the bonuses are the management people just ready to retire. So there are definitions, but usually it's a general definition and then with lots of specifics under it to catch the specifics.

MR. CAPPITELLI: Because I think what I would like to see is -- I know in a prior hearing we had a conversation about whether or not it should be called "spiking" or something else.

MR. BRANAN: Right.

MR. CAPPITELLI: But I think if we're going to call it "spiking," we need to define what it is we're talking about. And I think that's a good starting point. But the broader definition is that it's not only that, but it's anything that could have an adverse impact on this system, and then include the public perception, the credibility element to that, too. But I think that's what we're talking about here, is all of those things.

And then if you make that all-encompassing, I think all these recommendations that we're discussing
here would fall right into that, and people would be able to read it and see exactly where it fits.

MR. BRANAN: I'll go back to the three retirement systems that helped us with this and see if we can come out with a generally acceptable definition.

MR. CAPPITELLI: Okay, thank you.

CHAIR PARKSY: Okay, move on, Tom.

MR. BRANAN: The next topic under this general issue is "Disability Retirement Reform."

"Within the '37 Act, each county retirement board rules on disabilities within its own system. The CalSTRS board decides on disability applications in that retirement system."

"Prior to 1975, CalPERS made disability determinations for all state, school, and public agency members, as well as the decision of whether disabilities were the result of a job-related injury or illness for state and local safety members."

"After 1975, responsibility for disability determinations for local safety members was statutorily changed to local public agencies."

"Consequently, there can be significant differences between employers as to what constitutes a 'disability.'"

And probably a better way to say that is, there
are significant differences in the interpretation by employers as to what constitutes a disability.

These are out of order, actually. I'd rather take 13 first.

"Legislation should be introduced to return to decision-making authority for CalPERS local safety member disability determination to the CalPERS board."

CHAIR PARKSY: Okay, Lee?

MR. LIPPS: I think my comments are sort of overarching in terms of the whole question of why are we taking up disability reform in the first place.

As I understand it -- and perhaps I can be corrected if I don't understand correctly -- anything that we have here, there's no difference in terms of the impact on the retirement system whether somebody goes out on a regular retirement or a disability retirement. As I understand it, the difference is that if you're on a disability retirement, if you're a public safety officer, for example, then half of your retirement is tax-free and the other half is taxable.

In other public employee categories, it may not be half, it may be some 40 percent or 30 percent is tax-free. But the impact in terms of the disability reform or the impact of the disability retirement is really on the state in its losing some tax revenue, which
is very, very different than I think that we've been charged with.

I don't really -- as much as we'd all like to curb abuses and fraud and things like that, where we see them, I don't see this whole package of items as something that falls under our charge.

CHAIR PARKSY: Well, the theory was -- and we certainly can be responsive to that -- but the theory was that things that hurt the credibility of the system, are things that we should be reporting on, we should be commenting on, we should be identifying practices that try to address this. That was the underlying theory.

And I think, to some extent, disability fraud or disability abuse is within that.

Is that your --

MR. BRANAN: Well, that's part of it, Mr. Chair. But, actually, what you're saying is only true if the person has served long enough to have a comparable service retirement as to what they get for disability. A safety member who is disabled on their first day on the job qualifies for a disability pension.

Now, I agree, we're not talking about what -- it's not the place of the Commission to come up with a checklist of what's a reasonable disability. But the reason we're making this recommendation is, first -- and
it gets back to finances -- staff looks at pensions, health care, all of it coming out of essentially the same pot of money. So if there were savings on disabilities, that would be money available for other benefits.

The reason we think this should go back to the PERS board, as it once was, is the PERS board is the fiduciary body of the system. When they look at a disability application, they look at it, in my opinion, on those items that should be looked at, and that is the medical information.

What has happened at the local level, in some cases, is those people making the decision are not fiduciaries to the system. And a lot of personnel issues and disciplinary issues get mixed up in the decision of who should get a disability.

The system works very well at STRS. They have an excellent disability program. They also have a very tough program to get through and to show that you deserve it. But it works very well.

And in the '37 Act, each '37 Act board makes the decision for all disabilities of its members. And that was the case in PERS. They still make all those decisions except for local safety.

So we think it would be a much more rational, defensible system if the PERS board had that
CHAIR PARKSY: Bob?

MR. WALTON: Tom, I'm not arguing for or against what your recommendation is to agree somewhat -- or to agree entirely with what Lee said, looking at the public perception, and the fact that a number, if not a majority, in some cases, like Highway Patrol, are disabilities for a person already eligible for a service retirement. The public perception is that if there was less disabilities, it would, quote, "save money," where, in fact, it wouldn't. The cost to the system is the same.

I think that needs to be made -- the public needs to be made more aware of the situation and what's actually transpiring.

The difficulty at least from a process standpoint -- I know it's come up in the past -- on PERS doing these determinations. Even under the current system, we've had cases where public agencies -- and I'll look for someone for PERS to correct me if I misstate any of this -- have found a person disabled.

A person doesn't want to be disabled. They want to work. And they've appealed to the PERS board, and the PERS board has found them not to be disabled.

The bottom line is, though, the public agency
refuses to hire them back to work. So the member is put in a no-man's or no-woman's or no-person's zone: Well, they're not disabled but they have no job.

MR. BRANAN: Well, that's what I was talking about.

MR. WALTON: Because that's part of the problem. But you have to look at this in a larger context of exactly what the problem is and what the best approach is.

MR. PRINGLE: I think we should have a recommendation to ensure that there's no no-person zones created.

CHAIR PARKSY: Any other -- yes, Paul?

MR. CAPPITELLI: Yes. Okay, I think what the issue here is that we're trying to address deals with disability fraud or fraudulent-type actions; correct? I mean, that's the overarching goal?

MR. BRANAN: Yes.

MR. CAPPITELLI: I'm not so sure that -- and clearly, when you read through the abstract of the text of some of these legislative proposals here, it does address that. But I kind of struggle as to how Number 13 addresses that issue, how it really speaks to remedy that. The others are clearer to me than 13 is.

MR. BRANAN: Well, our thinking on Number 13 is
that you take it out of an environment where many more things than the question of disability get mixed in.

As Bob was saying, there are cases where somebody is considered a difficult employee. And rather than fire them, they find out they're disabled. I don't think that happens at the PERS board level. They have a much different perspective of why they're there, and a much narrower range of what should go into the mix.

MR. CAPPITELLI: Okay. And I understand that. I guess I just don't accept that notion. And as a career public-safety management person, I would suggest that those situations are far and few between.

In the broader sense, I think that the vast majority of the decisions that are made at the level by which they're currently made are probably made taking all the same factors into consideration. But I think we need to be careful over introducing recommendations that somehow speak to a very small, limited amount of possible things that could occur and forget about the broader picture here. I just don't want to be on the record just to say that I don't see how that recommendation speaks to the issue of fraud. It's not as clear to me as the others.

MR. HARD: Can I follow up, Tom, with that?

MR. BRANAN: Yes.
MR. HARD: He asked, well, how prevalent is this.

I guess, do we have statistics? I mean, we must have statistics on, like, convictions for disability fraud. But how big is this problem? Even though I agree that we should try to address perception of the public. But do you have any statistics on this actual problem?

MR. BRANAN: Well, first -- and on both these points -- 13, we're really not putting that forward as a remedy for fraud, but, rather, it's an opportunity to make that system more rational and more defensible.

As far as statistics, I don't think -- Bob would know more than I -- I don't think I've seen -- I know I haven't seen those statistics. I don't know if they exist. But that's something more that we were going to discuss under 12.

MR. HARD: So can I reasonably conclude that this is really about headlines in individual cases we've seen and bad publicity about bad individuals in the State of California?

MR. BRANAN: On 13?

MR. HARD: Disability fraud and trying to address it, yes.

Well, 13 you said wouldn't address fraud.

MR. BRANAN: That's right, yes.
MR. HARD: And that's good, because I was beginning to feel uncomfortable for the local boards and agencies about their determinations on disability.

Yes, so that's what I mean. But there's no statistics, but this is a problem because it's been in the headlines for an individual or two or three or...

MR. BRANAN: Well, certainly those kinds of things are in the headlines. And they're not rare as such.

MR. HARD: Well, if you don't have statistics, how do you know they're not rare? I really hope they are rare, but I don't know.

MR. BRANAN: I don't know. I just mean they're not rare in the media.

MR. HARD: They're not rare in the media? Okay, got it. I agree.

MR. BRANAN: There's a steady flow of those. That's not to say they are representational. But, no, they do provide bad publicity.

MR. HARD: Absolutely.

DR. GHILARDUCCI: Gerry?

CHAIR PARKSY: Yes, Teresa?

DR. GHILARDUCCI: I feel uncomfortable with some of the same reasons we all -- well, that's been expressed here, making some determinations on disability
without any hearings on it or experts testifying here.
And I know it's a huge issue all around the world, you
know, where people are trying to deal with training,
return-to-work issues, unemployment insurance bleeding
into disability insurance. This is a huge issue. And so
I'm going to turn to you, Gerry, and ask if you can
defend or make a case for us, as Commission members,
whether or not we should include this within our purview?
Because if we do, we'll need more testimony and
experts -- at least I would.

So can you make the best case for this?

CHAIR PARKSY: Well, I think the best case can
be made around evaluating best practices.

DR. GHILARUCCI: Yes, okay.

CHAIR PARKSY: Part of our charge is
identifying the magnitude of the obligations, presenting
best practices or approaches that have been taken that we
would endorse without necessarily applying it across
everything.

DR. GHILARUCCI: And this is a post-employment
benefit?

CHAIR PARKSY: Right, exactly. That's where we
might want to include it. I think what everyone is
struggling with is how does it fit within this.

DR. GHILARUCCI: I'm also struggling with I
don't know anything about it, about the disability situation in the state. That's mainly what I'm struggling with. We've had lots of testimony about all sorts of other things, but this is really unfamiliar.

CHAIR PARKSY: Well, maybe what we ought to do is to step back and think a little bit on the disability if we really think that it's important to include, and maybe we want to hear something more about it before we finish. And if we don't, then I think we at least ought to reference the fact that we didn't include it, even though it's an area -- one of the two, it seems to me.

MR. BARGER: Gerry?

CHAIR PARKSY: Yes, Matt?

MR. BARGER: I wouldn't want to step away from this one because I think it's sort of fascicled to pretend like the money doesn't come out of the same pot in the state.

And if you fund a bunch of pension -- and I don't know if there's a bunch or not a bunch -- pension promises and expect to get taxable income off of it and you don't, it's going to affect the finances of the pension system. I mean, it seems to me to be obvious.

Two, and just sort of anecdotally, things that bug people and sort of call into question the repute or the credibility of the system, the integrity of it, which
people have to believe in to continue to fund. This is one of those things that keeps coming up. And to sort of pretend like, oh, it's not an issue just because it's in the headlines, that doesn't seem like a reasonable thing to do, either. I mean, as long as there's even a handful of examples of it that continue to cause a problem, not addressing it just seems to be wrong.

How you exactly do it -- I understand Paul's point of, you just picked on public safety officers as the problem, and here's a recommendation to do it.

That isn't where I'm recommending going. I'm much more, I think, we ought to acknowledge, disability fraud is wrong, period. Two, to the extent there's some best practices that can go to address it, we ought to endorse those. To me, that would be the direction I would want to head, not more --

CHAIR PARKSY: Not just key into safety?

MR. BARGER: -- narrow something to one group or another personally.

CHAIR PARKSY: Bob?

MR. WALTON: Along those lines, in looking at Recommendation 13 -- and it's hard to remove yourself from 12, affecting that -- but an alternative to Recommendation 13 is for us to consider that a process for determining disability ought to include some best
practices, no matter where it's made, that do not take
into account personnel issues, discipline issues, saying
that and using the right words, as opposed to just
saying, "We'll move it from the local to PERS," but
saying "The process for determining disability retirement
needs to include these best-practice factors," whatever
those may be.

The difficulty going with what Jim indicated,
the "what is fraud" part of the recommendation you'll see
in 12 is, as I understood it at the time these were
drafted -- and I helped draft some of them -- in applying
for disability retirement, it's not fraud until you get
the money. So you can lie, cheat, and steal on your
application. If you're caught, it's no harm, no foul.
"Oh, I'm sorry, I lied." You haven't committed a fraud
yet. That's part of the definition -- which is
ludicrous, but that's how it works.

And so that needs to be changed to somehow
discourage that type of activity. But, again, that can
be part of the process, I guess.

MR. HARD: I would endorse, too, what Matt
said. I don't think we should ignore it. I just think
that moving it to CalPERS, one, without more context kind
of implies that the local boards kind of are suspect, and
then just moving it up to CalPERS; and then it really
doesn't address fraud unless CalPERS is better at ferreting out fraud than other agencies. And I don't know if that's factual, either.

But I think we should take the position out of disability fraud, that we're against it.

MR. BARGER: Yes.

CHAIR PARKSY: I don't think we can take a position that it is bad without elaborating on what's been done to try to address it, that we would state people ought to consider.

MR. CAPPITELLI: Do we have a consensus on Number 13? Because I think the way Bob stated it, I'm more comfortable with it that way where we talk about the broader concern and the broader issue. But an actual recommendation that suggests that we want to make this significant policy shift away from the way it's being done to something else that impacts all these people. I'm not so sure that addresses the issue.

CHAIR PARKSY: I think we can come back around without doing that and still endorse the notion of addressing abuses in this area without necessarily saying the recommendation that you've got laid out here.

MR. BRANAN: I think so.

CHAIR PARKSY: Okay, keep going.

What was 12 is now 13.
MR. BRANAN: Yes. Just by way of background for Number 12, in the last legislative session, there were three bills that were sponsored by PERS dealing with -- last gasp.

MR. WALTON: It got you all choked up, huh?

MR. BRANAN: Yes, it's very emotional.

CHAIR PARSKY: When you start listings AB’s, that chokes you up, I know.

MR. BRANAN: Yes. All three of these bills were sponsored by PERS. All of them dealt with disability fraud. This is not to be confused with disability abuse -- verbal abuse here.

So what happened was in the background material on page 21, we just briefly summarized these bills.

After some of you got your background material, you called me and said, in essence, "How are we supposed to make a decision like this based on no information on the bills?"

So this morning I handed out this document. It's my analysis of the three bills, and it gives also their legislative history.

And I think one thing that's worth pointing out is that two of these bills went through both houses of the Legislature with no "no" votes. One of them went through both houses with one "no" vote.
Now, for partisan reasons, these bills were kept in the Legislature and died eventually; but it had nothing to do with the content of the bills not being acceptable to both parties in the Legislature.

This year, those three bills have all been reintroduced. And in my discussions with some labor representatives, they are putting together a disability-abuse package for January 2008. And they think that these three bills may very well be included in that package.

So for that reason, we have this recommendation: The Commission endorses the reform policy language found in the current legislative sessions AB 36, AB 219, and AB 545, and urges that the Legislature enact that language in 2008.

And what I tried to get across here but based on earlier discussions today, I may not have done that. This is not saying that you should endorse these three bills now, but the concepts found in the bills. Because if they are included in an omnibus bill next year, they won’t have these authors or these bill numbers. And that's why it made sense that you use a description of what's actually in the bills.

CHAIR PARKSY: Yes, Curt?

MR. PRINGLE: Yes, on this, looking at the
quick synopsis on page 21, the one-sentence version of what you're talking that the bill is trying to accomplish, I feel comfortable with it, and I'm sure most everyone else does.

On this one, though, it gives me maybe an opportunity to suggest, I would really like to think, Mr. Chairman, when each of these recommendations are presented, how they can be presented in a consistent format. And in that regard, where we're directing certain state action, we should say things like what was referenced in Recommendation 13: "Legislation should be introduced to" or "Legislation should be introduced to enact," and then articulate what we want to have enacted. When we want to direct CalPERS to take an action: "CalPERS, CalSTRS, and other retirement agencies should do this," "Local governments, in developing a compensation plan, should do this," so that we are really, specifically, clearly saying: This is what should be enacted.

In this regard, I like all of these and this is fine. I just think we should say again, "Legislation should be introduced and enacted that does..."

CHAIR PARKSY: And, in effect, extract the policy language?

MR. PRINGLE: Right.
CHAIR PARKSY: Or the form policy language from each?

MR. PRINGLE: I really -- and I know what Tom's trying to do. I always have hesitancy of ever referencing a bill number at a moment in time knowing exactly what's there or what's not, there's a technical flaw in it, there's some issue. We just have to say what the policies are that we want to enact so, again, when the reader looks at this report, they know what we're seeking and why we're seeking it. So that would be my recommendation.

CHAIR PARKSY: And you could still introduce it with a reference to whatever bills you want to refer to that attempted to do this; but going forward then, take the -- as far as the recommendation, take the bill references out and put the policy language in that we want to have included; is that --

MR. BRANAN: That would be fine.

CHAIR PARKSY: Is that okay with everyone? All right, let's keep going.

MR. BRANAN: The next broad category is "Operational and Administrative Governance."

"Pension fund governance has received greater attention in recent years as pension funds have become larger and investment options more complex."
“Concerns have also been raised about retirement system mismanagement, misuse of funds, and conflicts of interest.”

"Retirement systems have adopted reforms to address these governance issues."

“The rules to eliminate 'pay to play' have been adopted by the CalSTRS board.”

AB 246 was recently signed by the Governor. It prohibits county retirement board members from selling or providing investment products to any '37 Act retirement systems.

And SACRS, which is the umbrella organization for the twenty '37 Act retirement systems, SACRS has created the Uniform Trustee Appointment Policy, which recommends appointment procedures and qualifications for appointed retirement board members.

"According to best-practice literature, effective fund management requires that the appointed members of retirement system boards should have expertise which balances representation of members and the public and minimizes political influence and economic conflicts of interest."

Number 14 is: "Trustees of public retirement systems should receive continuous training related to the understanding and fulfillment of their fiduciary
responsibilities, as well as ongoing training for the investment of fund assets."

CHAIR PARKSY: Okay, no objection.

Bob?

MR. WALTON: Just one editorial comment. The investment of assets is a fiduciary responsibility. So I would just change that “including the investment of assets” as -- it sounds like now it's in addition to.

MR. BRANAN: That's true. And that wasn't the meaning we were looking for.

MR. WALTON: No, I understand.

MR. BRANAN: But we wanted to emphasize fiduciary duty. In most cases, people want educational programs for investments, and then throw in something about fiduciary duties.

MR. WALTON: I understand.

DR. GHILARUCCI: This is something I've thought about many decades. And I'm just wondering if your language isn't too weak.

There's lots of programs that are called "training programs," and they're just one long golf game. And it's a big waste of money.

No offense to the golfers.

MR. WALTON: You said that like it was a bad thing.
DR. GHILARUCCI: And the men are talking to each other on the golf course, right, and very little training goes on at all.

CHAIR PARKSY: Let's not just make reference to the men on the golf course, or make reference to the boys, or nothing like that.

DR. GHILARUCCI: Show me a gaggle of women trustees on the golf course and I'll eat my words.

But that actually speaks to even bigger issues about how exclusive and cliquish, you know, these so-called training programs are. It's something that I care a lot about, and there's been lots of evaluations about how effective this training is.

So if we can put any language about quality training or recognized training or credentialed training, I'd be happy.

MR. BRANAN: Actually, we wrestled with that, to the point of naming some places.

DR. GHILARUCCI: Yes.

MR. BRANAN: But I think we could use some help with that.

DR. GHILARUCCI: I can help. Maybe I could help you with that. I will help you with that.

Also, I think adding the clause that "as well as ongoing training for investments" defeats your
purpose, because much of that training, when it happens between, you know, tee-offs, is only about investments. And people can walk away with lots of sophisticated knowledge about style differences in mutual funds and equities, but really have not a clue what an unfunded liability is. And that, I think you were trying to write that in balance. So I would say “as well as ongoing training for actuarial assumptions or actuarial methods,” and you really emphasize it that that training has to be balanced.

CHAIR PARKSY: Matt?

DR. GHILARUCCI: And there should be exams at the end of each quarter.

MR. CAPPIETTELLI: We thank you, Professor.

DR. GHILARUCCI: And indoors, right.

CHAIR PARKSY: No exams on the golf course.

MR. PRINGLE: In Anchorage.

DR. GHILARUCCI: Right.

In Indiana.

MR. BARGER: I actually have the same reaction, which was this is fine, but it's incredibly weak. And not only in regards to training but sort of qualifications for who should be able to serve. You know, this is an increasingly a complex area, both on the investment side and --
DR. GHILARDUCCI: Right. Yes, and the corporate side.

MR. BARGER: We've been sitting here for a long while. I don't think we would score 100, with the exception for Bob, on our actuarial test on pension plans.

This is not an easy area. And having some sort of standards that say, you know, preference for actuarial backgrounds, finance backgrounds, academic -- I mean, just in some ways, establishing that there are best practices for who should be on these and how they're picked, and what you're agreeing to, your political background. I mean, having some process that's trying to get the best and the brightest with representative backgrounds strikes me as that ought to be the best practice for that as well.

CHAIR PARKSY: Well, and I guess inherent in that is the overall -- I guess at one point we had a reference to board composition in the heading, and it wasn't -- we didn't quite include that here.

MR. BRANAN: Well, that's true. Board composition is something that's now covered by Proposition 162. To change the composition of a board requires a vote, a majority approval of the electorate within that area that the board covers. So, say, for
PERS or STRS, you'd have to have a statewide election.
We didn't include it largely for that reason.

But I think Bob Palmer here can give some
detail on what we mentioned in the background as the
SACRS policy for who should be appointed. And we're
talking about appointed members.

MR. PALMER: Yes, thank you. Within the
Government Code that sets up the 1937 Act, it defines the
type of members that could be serving on the board of
retirement. Some are appointed and some are elected. So
the SACRS organization developed a proposal that they
present to all 20 county supervisors on what they should
be looking at for criteria for future appointments to
their board of retirement.

There is no mandate and there is no requirement
that they do that; but it was done trying to focus on the
need for the expertise that we think this business needs.

I was just told that the City and County of
San Francisco also has a criteria in place that they use
for that. That causes a problem. If you're going to
look at the appointees, what do you do about the elected?

How do you handle the elected?

And so the language that you see up there goes
to, if you will, both sides, but in particular, about the
elected ones, the officials, participating that they will
have continuous, ongoing training.

As has been pointed out, there is a lot of training for investments but not a lot of serious, accredited, strong training for the other side of our business -- the liability side of our business. And so that's why we wrote this thing, if you will, backwards. We're trying to highlight that fiduciary responsibilities are critical in addition to investments. And so that's why the language was presented to you in that fashion.

CHAIR PARKSY: Well, but I do think that maybe inherent in Matt's point, although you may have a difficult time because, by statute, where the appointments come from, I do think that trying to make sure that the composition of the boards carry with it experience in areas, somehow we ought to be able to emphasize that.

I mean, in either of these two areas that have been mentioned, either in the investment area or in the actuarial area, the notion that you will be able to train an inexperienced person to become -- to carry with it expertise, I think, is a stretch. That doesn't mean that you should have training; and you certainly should have training about your responsibilities; but I do think that it's going to be -- certainly on the investment side, it will be very difficult to kind of bring someone who is
not experienced to a knowledge base that would, quote, reach qualified status.

MR. BRANAN: Well, two things: One, I think we should keep in mind that investment boards or retirement boards in the public sector aren't like retirement boards in the -- what did I say, the private sector? Those in the public sector are not like those in the private sector, nor should they be.

CHAIR PARKSY: Right.

MR. BRANAN: In the public sector, there are, and I think should be, representatives of the public and of the members on the board. And although there is, it seems, a growing literature out there that some of those people should be replaced by investment experts, I think that is a very narrow look at the public sector.

And the other half of that is, if you look at the history of public pensions and the investments that they've made, most of those decisions are made by chairs who are the elected members of the board. Now, obviously, the chair doesn't make all the decisions.

CHAIR PARKSY: Right.

MR. BRANAN: But just because they came in with limited knowledge doesn't mean that with hiring the correct professionals as advisors that they can't make good investment decisions.
CHAIR PARKSY: No question about that.

It's just that the reference to training would suggest that training can almost put someone in a position of being able to take the place of the expertise that they bring to bear, not necessarily change the composition.

Curt?

MR. PRINGLE: And I just want to -- Prop. 162 pretty much delineates categories of where individuals come from as opposed to further delineation, saying that a collective pool should have certain talents and components.

And I don't think when you talk about board composition we're really going against, you know, mandating something on a '37 Act county, necessarily, or mandating that we overturn Prop. 162 or go for a vote, if we say, "...and the collection of appointees should include someone with experience in actuarial, or with actuarial knowledge, someone with experience in liabilities or plan management, someone with experience in this."

I mean, most boards and commissions in the state do, in fact, have those underlying conditions, not necessarily just saying, "The Legislature gets one appointment," but, in fact, say that among this pool of appointees -- among the Governor's five appointees on
CalSTRS, one should have an actuarial knowledge and one should -- or whatever. I mean, those are the levels, I think, of encouragement we could make so you not only have -- we don't need to disturb the appointment pool process.

I would assume, in many instances, there are folks that come from the represented communities that have experience in a lot of those things. And, you know, if, in fact, one of the bargaining units that are represented on that have someone they wish to offer with that knowledge, I think that just adds to it.

And setting a guideline as to what are some of those things that we think are important to have reflected in your membership, your board composition, I think would go a long way to suggest. We just don't want bodies to fill the seats that are appointed from certain places but, in fact, bring certain talents to those seats as a collective.

MR. BRANAN: That's a good point. And we will send out this week the SACRS policy document that Bob was just talking about, because that's exactly what it does. It says, "Of the appointed members, we recommend that you look for the following qualities."

DR. GHILARDECCI: Yes, I want to clear up what I said, too, when I said we should have exams. And it
wouldn't have been -- my perfect exam, based on the research about what makes an effective trustee and what makes an effective board, in terms of actually yielding good rates of return and stable contributions and benefits, are qualifications that refer to whether or not a trustee can recognize a conflict of interest, whether or not they understand the role of staff and the experts, and put their recommendations in proper perspective.

This is the catch-all fiduciary, but it's an important part of the skill base that they need.

Whether or not a trustee has to have a time perspective that exceeds the quarter or a year, they in some ways have to think about the whole list of needs of the employer, the taxpayer, and the beneficiary, at the same time making the beneficiary and the participant the primary beneficiary. That all takes judgment. That would be on my ideal test and would be a part of my training.

So there are lots of reasons to have representatives from different constituent groups, and lots of reasons to have training. But it does have to be of a particular kind or else it's worse than nothing. You know, that it's a waste of time, but it also could cause the wrong decisions.

MR. BRANAN: Well, we'll get in touch with you
this week.

DR. GHILARDUCCI: Okay, I have some citations.

CHAIR PARKSY: Bob?

MR. WALTON: I like the idea that Teresa and others have talked about, of having a best practices as to training, and especially I would agree with Bob. It's really the liability side that's underrepresented, it's not the asset side.

DR. GHILARDUCCI: Right.

MR. WALTON: But, really, the responsibility of a fiduciary is not to become an expert, it is to hire experts.

DR. GHILARDUCCI: Right.

MR. WALTON: To recognize where they don't have the expertise and have the ability to hire, and depend on those experts where they need them. And so training in that regard is always helpful.

I think as part of that, we've talked about an advisory actuarial panel or board of some sort. That would be a wonderful group to recommend courses to learn about actuarial science for a pension fund and for an OPEB trust as an example. So that's really what has to take place.

My specific knowledge about PERS, with one exception, the appointed members come from a particular
point of view, like one of the Governor's appointees represents local government. They have to be a local elected official.

MR. BRANAN: And that's set out in the law.

MR. WALTON: That's right, it's set out in the law.

The one that represents the public, that doesn't have an expertise other than representing the public, is a legislative appointee, if I recall.

But all have some segment that they're supposedly representing.

One of the things, I think, in my experience, though, is once you become a fiduciary, you don't represent just that perspective; you have to represent the entire membership.

DR. GHILARDELLI: Right.

MR. WALTON: You can't sit there and say -- or even the elected side -- "I was elected by the retired members, and here's what they think."

Well, that's part of the education. When you become a fiduciary, you have to represent the total system.

So I think the process of delineating best practices for education and training in this area, and especially highlighting the liability side, however you
want to characterize that, is really important.

CHAIR PARKSY: Matt?

MR. BARGER: I want to point out, you're touching on the established pension plans, you're presumably at some point going to suggest setting up some form of trust or parallel universe for OPEB, where this is all fair game.

MR. BRANAN: Yes.

MR. BARGER: And so saying, "Oh, this is needed for a pension plan system," doesn't mean they have to copy exactly the same thing for this, and presumably they've got a whole slate of new people to choose, so it would be nice if they started out with some best-practice recommendations of what would be a good composition to do that.

MR. WALTON: That's a good point.

CHAIR PARKSY: That's a very good point.

Lee?

MR. LIPPS: As a trustee on a private-sector trust, it's my understanding that I am required each year to undergo at least 15 hours of continued education training each year. I mean, that's an actual requirement. It's not just --

DR. GHILARDDUC: Your board would have set down that requirement. It's nowhere required in the law.
So each pension board would have its own requirements of its trustees.

MR. LIPPS: Okay, it's my understanding -- and it wasn't the board -- is that this was something that certification was required for, that I attended the training, which is why the International Foundation is such a popular place.

DR. GHILARDUCCI: Yes, that's good. Yes.

CHAIR PARKSY: Okay, Tom, do you think you have the sense here?

MR. BRANAN: Yes.

CHAIR PARKSY: Okay, Teresa will help you.

DR. GHILARDUCCI: Yes.

CHAIR PARKSY: Okay.

MR. BRANAN: "Adoption of sound governance policies helps to ensure better organizational performance and fewer conflicts of interest and provide less opportunity for misuse of fund assets. Such policies also lend credibility to the governance requirements which trustees place on companies where plan assets are invested."

Number 15, "Boards which oversee pension and OPEB trust funds should meet or exceed the transparency governance requirements they place on companies or other investment vehicles where plan assets are invested."
CHAIR PARKSY: Here's where Sarbanes-Oxley comes in.

DR. GHILARDUCCI: Yes.

CHAIR PARKSY: Okay, let's just pause on that one.

I'm not quite sure how people would interpret what it means, but how do people think about that general reference.

DR. GHILARDUCCI: That's great.

MR. HARD: It sounds good to me, but I don't know how it would be implemented or whatever.

CHAIR PARKSY: Well, I think a question is, in your mind, Tom, it's clear as to the requirements that individual boards place on companies?

MR. BRANAN: Yes, and we --

DR. GHILARDUCCI: It's Sarbanes-Oxley.

MR. BRANAN: -- we especially added transparency here, so that it doesn't apply to all governance requirements. And if you would like, when we bring this back for final approval, we can add a few examples.

CHAIR PARKSY: I don't see how -- I don't see how people can object to this, it's just a question of -- it certainly wouldn't be uniform. Different boards will take a different approach.
DR. GHILARDUCCI: That's okay.

CHAIR PARKSY: That's okay.

DR. GHILARDUCCI: As long as they have the internal audit.

CHAIR PARKSY: Okay, keep going.

MR. BRANAN: Number 16.

CHAIR PARKSY: Keep going.

This will be the Teresa-Sarbanes-Oxley recommendations. Okay.

MR. BRANAN: “Public retirement systems boards and trustees should publish an independent audit committee made up of trustees to oversee and participate in the opening, processing, and closing of the annual audit report to the full board. This recommendation is made to make trustees more active participants in the audit process."

CHAIR PARKSY: The last sentence I'm not sure quite fits with all the other recommendations to explain why.

DR. GHILARDUCCI: Right.

CHAIR PARKSY: You can introduce that.

DR. GHILARDUCCI: It should be a background.

CHAIR PARKSY: Yes, it's not quite consistent, but I think we understand why.

Any objections to this best practice or this
recommendation?

MR. CAPPITELLI: No objection.

MR. LIPPS: I guess my question would be going back to something you said earlier, Gerry. Even with a great deal of training, could we bring trustees who are either elected or appointed by virtue of their office, could we bring them up to a level to understand fully enough about the audit process to oversee it?

CHAIR PARKSY: Well, I think inherent -- correct me, Tom -- but I think inherent in this recommendation is a separation of board responsibility with respect to audit and executive/staff responsibility with respect to audit.

Isn't that the distinction you're trying to draw?

MR. BRANAN: This comes not from the statewide retirement systems, as much as what some of us have observed in local retirement systems, where the auditor comes in, sits down with senior staff, has the audit, and the trustees are essentially inert and they receive the audit report.

What we're trying to do is to get a group of them that will have, by virtue of being on the audit committee, a responsibility to get into it and to understand what's going on.
CHAIR PARKSY: Well, and the audit report -- or independent auditor would be reporting to the board as opposed to the ongoing management.

MR. BRANAN: Well, and they do report to the board currently. But if the board hasn't played any role in it, it's not as valuable an experience as it ought to be.

CHAIR PARKSY: That's true.

Okay, next?

MR. BRANAN: 17, "Boards which govern pension and OPEB trusts should have very strong conflict of interest policies. All trustees should annually attest in writing that they understand and are in compliance with the conflict-of-interest policy."

So we are not saying what that conflict-of-interest policy should be; but going back to what Mr. Walton said earlier, there is often a lapse of any memory about what you were told at a given time. And that's why trustees should annually say in writing that they understand the policy and that they adhere to it.

CHAIR PARKSY: Are there any comments there?

MR. CAPPITELLI: No, no objection. It's a great recommendation.

I think we ought to kind of expand or focus in
more on what those policies should be and how they should be written. Maybe something that's more standardized, the best practice, or something of that nature. Because I think if you just put that recommendation out there, you really leave it up to the individual boards and groups.

I'd like to see something that's more of an organized or collaborative effort to come up with something that it doesn't necessarily need to be part of this recommendation, but it could be an ad hoc group that could be established to come up with a best practice and best recommendation, and then they be disseminated to all these different boards.

MR. BRANAN: We could develop that before the next meeting. And if you are in agreement with it, it could become part of the index or the appendix on the final report.

MR. CAPPITELLI: I think that would be even better.

DR. GHILARDECCI: That would be wonderful.

MR. CAPPITELLI: Even stronger, yes.

CHAIR PARKSY: Okay.

DR. GHILARDECCI: We just missed Thanksgiving.

CHAIR PARKSY: Tom, any others?

MR. BRANAN: No, that's it.
CHAIR PARKSY: Before we conclude, I just wanted to come back on a subject that I think was a little bit confusing, I mentioned it to Tom, and that has to do with our discussion of prefunding. There were some questions raised about what the magnitude of the dollars needed to be in order to fully prefund beginning now, in the upcoming budget cycle.

And I thought it would be helpful just to make sure we clarified that, and not necessarily changing any of the recommendations that are being redrafted. But let's separate out the amount of money necessary to fund the pay-as-you-go amount. That, as I understood it, was $1.3 billion?

MR. BRANAN: That's correct.

CHAIR PARKSY: And that, it was assumed, as it has in the past, would be in the current -- in the upcoming budget. That's just being assumed that that would be the case.

What we were talking about is how much incremental money would be necessary to prefund the, quote, "unfunded liabilities" that are accruing over and above the $1.3 billion.

MR. BARGER: Of those two, isn't there the normal cost and the amortization?

CHAIR PARKSY: Yes. And I thought it was
confused. So we start with the current cost, that's the $1.3 billion.

MR. BARGER: Yes.

CHAIR PARKSY: Now, that is somewhat irrelevant to the question of prefunding. So we can put that aside for the moment. It's dollars in the current budget, so it's not a question of whether the money is needed.

But in just trying to address the notion of do we want to recommend prefunding begin at the state level, and if so, to what extent -- partial, full, whatever -- and do we want to use a specific number, just to give everyone the notion of what it would take to be fully prefunded, what would that number be.

MR. BRANAN: As I recall, Mr. Chair, the total number would be about $2.59 billion.

CHAIR PARKSY: The total number of what, though? That was what was --

MR. BRANAN: You pay as you go, and then added on to it approximately $1.3 billion.

CHAIR PARKSY: Yes, so that was the confusing thing. It's approximately $1.3 billion on top of what would be the pay-as-you-go, $1.3 billion.

MR. BARGER: Let's just say, the normal cost is 2.6.

MR. BRANAN: That is your full prefunding cost.
MR. LIPPS: No, that would only just be the pay-as-you-go; and the normal cost, which is the cost from today going forward, doesn't include the ARC, which is the accrued unfunded liability. That's what we're trying to get.

CHAIR PARKSY: That's what I think needs to be clarified -- well, two things need to be clarified: One element of statistic, which is what does it take to actually honor the pay-as-you-go number. That's $1.3 billion. I think everyone has agreed with that.

Now, the question is, what more do you need to do -- I think if John Cogan were here, he would emphasize the importance of not just looking at the current obligations going forward, but at the obligations that have accrued in addition. So that's what I think would be helpful to clarify.

MR. LIPPS: And if we could have them broken out between each of those three groups, both the normal cost and then the unfunded liability.

DR. GHILARUCCI: Right. Liability over 30 years.

CHAIR PARKSY: And who are you bringing to the table?

MR. BRANAN: I'd like to introduce Mr. Tom Dithridge. He's from the Department of Finance, and is
prepared to talk about this.

CHAIR PARKSY: Do you work with our executive
director when there's another hat on, is that --

MR. DITHRIDGE: I do occasionally, yes.

The report that was prepared by the actuaries
indicate that if we were to fund -- fully fund the ARC,
we would need to spend about $2.6 billion. About
$1.3 billion of that is what we're currently providing in
the budget. And that includes the $1 billion to
$1.1 billion that we spend for state employees for the
current benefits -- for the retirees, for the current
benefits; and it includes the implicit subsidy that has
to do with the way the rates are structured. And we have
a single rate for all employees.

The remainder would then fund the unfunded
liability for retirees and for existing employees.

DR. GHILARDELLI: Would be how much?

MR. DITHRIDGE: What?

DR. GHILARDELLI: Is how much?

MR. DITHRIDGE: That would be the 1.3.

CHAIR PARKSY: So the total of the two,
including prefunding what's referred to as the ARC, was
2.6?

MR. DITHRIDGE: Right.

CHAIR PARKSY: And, again, you would just take
away the two 1.3's to get there, but you take away the
1.3, which is the obligations currently due in the
current year --

MR. DITHRIDGE: The pay-as-you-go.

CHAIR PARKSY: The pay-as-you-go, and you still
have another 1.3?

MR. DITHRIDGE: Yes.

CHAIR PARKSY: And that would take care of both
the retirees and the existing employees?

MR. DITHRIDGE: Correct.

CHAIR PARKSY: On the prefunded basis; is that
right?

MR. DITHRIDGE: On the benefits as they're
accruing, yes, the so-called normal cost.

DR. GHILARUCCI: So paid over how long?

Thirty years?

MR. DITHRIDGE: Thirty years.

CHAIR PARKSY: Let's ask the questions we need
to ask.

MR. DITHRIDGE: By the way, it also includes
the unfunded liability for the existing -- yes, that's
right. I'm sorry, yes.

CHAIR PARKSY: We've covered that.

Matt?

MR. BARGER: Teresa and I had the same
question.

MR. LIPPS: Do you have a sense -- let's forget the pay-go part, the first 1.3. The second 1.3, do you have a sense of the breakout between normal and the ARC? Because the numbers that you're saying are different than the numbers that I recall hearing in a much earlier presentation.

MR. DITHRIDGE: Let's clarify --

MR. LIPPS: That's what I'm trying to --

CHAIR PARKSY: This is an important point that we need to make is to make sure that everyone understands the numbers we're talking about.

MR. DITHRIDGE: Let's clarify. The ARC is the actuarially required contribution. That is a term that has been developed by GASB. And that is the $2.6 billion.

If you fully fund -- if you're going to fully fund over 30 years, it's $2.6 billion.

MR. BARGER: And fully funding meaning including taking care of the existing $46 billion --

MR. DITHRIDGE: No, the $46 billion is a different number. That is the obligation, if we do it on a pay-as-you-go basis. And what it does -- and this is the way the accounting board set it up -- it takes the unfunded liability and then looks at what it would take
to amortize that over 30 years at about 4½ percent, I think is what they used in there, which is what the State gets on its short-term investments. It's sort of a contrived number for accounting purposes.

MR. BARGER: Okay, so you're saying it's not the 46, it's the second number, it was the 30 or something?

MR. DITHRIDGE: The 30 -- if we want to -- if we decide to fully fund the --

MR. BARGER: It would take 30 years --

MR. DITHRIDGE: -- the normal and the -- yes, over 30 years, the normal cost and the unfunded liability, the report says that we need to spend $2.6 billion a year.

DR. GHILARUCCI: Every year?

MR. BARGER: Just for clarity, that includes the 1.3 million pay-as-you-go?

MR. DITHRIDGE: Yes.

DR. GHILARUCCI: Every year, an annual contribution. That's not a level --

MR. DITHRIDGE: Right, that would be a 30-year --

DR. GHILARUCCI: Annual payment?

MR. DITHRIDGE: Yes.

CHAIR PARKSY: And doing it that way, taking
all the calculations, at the end of the 30 years, you
would be fully funded for the obligations?

MR. DITHRIDGE: And now there's another caveat
in here. This is on a closed group because it's not
figuring in the growth of employees.

DR. GHILARUCCI: Right.

CHAIR PARKSY: Okay.

MR. DITHRIDGE: So it's going to change every
time they do the valuation.

CHAIR PARKSY: Okay, but if, in the -- if the
infinite wisdom of the Department of Finance, if the
infinite wisdom of the Department of Finance -- you're
included -- and the State Legislature decided that you
wanted to fully prefund as defined, then you would
include 2.6 billion in the forthcoming budget?

MR. DITHRIDGE: That gets a little bit -- we
would be including 2.6 billion. But remember that part
of that is actually included in what we're paying for
active employees for their health benefit, because we
have the implicit subsidies. And that's paid on behalf
of active employees.

And just as a little background, the theory is
that older employees, which retired employees are going
to be predominantly, are going to have higher health
costs on average than younger employees. So if you have
the same rate for everybody, there is a subsidy that the younger employees are paying on behalf of the older employees because they're not taking advantage of the level of services that the older employees are taking advantage of.

CHAIR PARKSY: That clarifies a lot, I'm sure.

But let me just state -- and this gets back to what I think Lee was asking -- which was we heard from another member of the Department of Finance in testimony, and I am sure that it was perfectly consistent with you, because you're all part of the same department. And that was how much money would need to be found, if you will, in the current budget cycle in order to honor a policy that said, "I want to begin fully funding -- fully prefunding," if you will.

MR. DITHRIDGE: Right.

CHAIR PARKSY: And I guess one answer, if I've got this right, one answer is, "Well, it's a given that $1.3 billion will be in, in the current budget."

MR. DITHRIDGE: Okay.

CHAIR PARKSY: But you still have somewhere between a seven or eight billion, maybe higher, deficit potential.

So on top of being able to find that money, if we were going to fully prefund, you would -- and that
includes an assumption that the $1.3 billion will be in it -- you'd need to find another $1.3 billion, thus increasing whatever that deficit is, you have to find another $1.3 billion.

MR. DITHRIDGE: That's correct. But I think that the $7 billion shortfall number you're talking about is a general-fund number. Not all of the 1.3 billion --

CHAIR PARKSY: Sorry.

MR. DITHRIDGE: -- additional is general fund.

So that's going to be --

CHAIR PARKSY: Forget about the shortfalls. Inherent in a recommendation to your department to fully prefund, would be the need to find another $1.3 billion?

MR. DITHRIDGE: It would certainly exacerbate the situation, and we would have to find additional funds.

CHAIR PARKSY: We have great confidence in you, so that's perfectly okay.

I think, at least from my standpoint, but I think I understand those numbers. And I was confused there. I really thank you very much.

Any other thoughts?

If not, we're adjourned.

(Proceedings concluded at 2:41 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 20th day of November 2007.

_______________________________
DANIEL P. FELDHAUS
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