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Post Employment Benefits: Issues & Remedies

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Contra Costa County

"Contra Costa County plans to spend no money this coming fiscal year on its skyrocketing future retiree health care bills, further increasing an obligation that now stands at $2.6 billion."

Contra Costa Times, April 18, 2007 ("Contra Costa supervisors put off tough budget decision")

Contra Costa County

"The decision came Tuesday as the Board of Supervisors gave preliminary approval to the county's 2007-08 budget, earmarking $33 million to pay for a year's worth of health care services guaranteed to retired county employees. But that comes up far short of the $227 million that a county consultant determined should be set aside to close the health care gap in the coming decades."

Ibid.

Los Angeles County

"Chief Administrative Officer David Janssen said early estimates put the county's retiree health care deficit as high as $14 billion, some $5 billion more than the previous estimates."

Los Angeles Daily News, April 18, 2007 ("Budget plan addresses health cost; Retiree tab grows to nearly $400 million")

Los Angeles County

"The annual taxpayer tab to pay for retiree health care costs has grown from about $200 million in 2003-04 to nearly $400 million for the fiscal year that begins July 1. The costs are expected to hit $500 million by 2010-11."

Ibid.

Los Angeles County

"Despite the retiree health deficit, Janssen said revenues are up for the third consecutive year, primarily because of elevated housing prices. However, officials warned that the slowing resale market presents the biggest risk to the county's revenues and proposed a conservative 1 percent increase in spending."

Ibid.

sacramento County

- "A housing slump that has wiped out countless millions of dollars in Sacramento-area home equity is soon to give a few million back.
- "Letters to 50,000 Sacramento County homeowners are being mailed today announcing cuts of up to 10 percent in their fall property tax bills, said Sacramento County Assessor Kenneth Stieger.
- "The rollback will erase about $15 million in revenue for schools, the county of Sacramento, its seven cities and numerous special districts, Stieger said. It affects 12.8 percent of the county's 390,000 residential parcels."

The Sacramento Bee, April 20, 2007 (Title is above).

Defined Benefit Pension Plans

"For such a plan to give real security, the financial strength of the company and its economic success must be reasonably secure for the next forty years. But is there any one company or any one industry whose future can be predicted with certainty for even ten years ahead? The recent pension plans thus offer no more security against the big bad wolf of old age than the little piggy's house of straw."

- Peter Drucker, 1950

Issue Number One

Opaque Contract Negotiations Benefit Union Negotiators

Remedies

- Open and public negotiations
- Discontinue closed-door discussions with minimal public notice of proposed contract before an open vote
- Retain independent third parties to negotiate employee bargaining unit agreements

Issue Number Two

Approving Retroactive Benefits =
Immediate Unfunded Liability

Remedies

- Treat proposed enhanced benefits as a debt subject to Propositions 13 and 218, requiring the vote by the municipality's constituents
- Require immediate payment of actuarially unfunded benefits the day they become effective
- Require increased employee contributions to cover the cost of enhanced and retroactive benefits (e.g. Orange County General Employees)

City and County of San Francisco

"San Francisco's retirement system is 104 percent funded. San Diego is 65 percent funded, the lowest among eight of the state's largest pension systems. The Orange County pension system is 69 percent funded."

"San Francisco's success is largely attributed to an unusual law that goes back more than a century: The city requires voter approval for any pension plan change, including benefit increases."

San Diego Union Tribune, *September 11, 2005*

Issue Number Three

Increasing Life Expectancy and
Decreasing Retirement Ages

Remedies

- Increase minimum age of retirement from 55 to at least 62 for General Members and from 50 to 57 for Public Safety Members in order to reduce workforce exodus and double-dipping
- Limit Cost of Living Adjustment (COLA) percentage provisions

Issue Number Four

Salary Spiking

Remedy

Discontinue remuneration calculations based on only the last year of employment

Issue Number Five

Actuarial assumption and amortization abuses

Remedy

Standardize

Interest Rate Assumption

Gradually lower the required rate of return -- and invest accordingly. Over the long term, this is an essential step for reducing the taxpayers' collective risk. It also would reveal the true economic costs of current benefits.

E. J. McMahon, "Public Pension Price Tag," The Wall Street Journal, August 21, 2006

Issue Number Six

Asset allocation abuses

Remedy

Incentivize money managers to do the right thing

Issue Number Seven

Pay to Play

Remedy

Prohibit it

Issue Number Eight

Disability retirement abuse

Remedies

- Develop stronger penalties for fraud and “Chief’s Disease”
- Modify “presumptive” code provisions

Issue Number Nine

Employer Contribution Holidays

Remedies

- Require escrow accounts
- Discourage unrealistic deferral and smoothing methods

Issue Number Ten

Sluggish Taxpayer Wages Support Growing Pension Costs

Remedies

- Implement two-tiered plans, so that future hires have smaller guaranteed pensions
- Consider defined contribution plans/hybrids in order to share the risk burden

Dc proven better than db

"California state workers under age 50 who work for a period of 10, 15, or 20 years would potentially receive a higher retirement income if California switched from its current defined benefit (DB) plan to a defined contribution (DC) plan, according to a new study by the Pacific Research Institute (PRI), a free-market think tank based in California."

Pacific Research Institute, February 14, 2006

Three (Five) Standard Public Sector Solutions

- Borrow your way out of debt by using Taxable Pension Obligation Bonds (POBs)
- Increase (enhance) the yields on the pension funds (assets) under management
- Increase employer contributions into the pension plan (tax increase?)
- (Chapter 9 Bankruptcy – unproven)
- (Freeze or terminate – private sector solution)

Orange County Addresses Retiree Medical Program

- The unfunded actuarial accrued liability is determined to be $1.4 billion at June 30, 2006
- The Annual Required Contribution is determined to be approximately $130 million (some 11.5 to 13% of payroll)
- The County is still paying some $90 million per year on its bankruptcy related debt

Orange County Addresses Retiree Medical Program

- Outside legal opinion: the retiree medical benefits were not vested
- Need to be renegotiated through the employee bargaining process
- Met with stakeholders
- Formed committee that included CEO, Board Chair, Supervisor-Elect, Auditor-Controller, Director of Public Finance, Budget Director and Actuaries

Employer Concessions

- Take over the required 1 percent payroll deduction from employees
- Take on another 1.2 percent of payroll contribution, on top of existing 1 percent program (totals 3.2 percent)
- Establish GASB 45 Trust and make total annual required contribution (ARC) on an annual basis

Employer Concessions

- Move the investment of the Trust corpus from the Orange County Treasurer (historic 4.25% annual yield) to the Orange County Employees Retirement System (interest rate assumption of 7.75%), effective January 1, 2007
- Required special legislation that was signed by the Governor (vetoed similar legislation allowing Cal PERS to do same)

Employer Concessions

- Employees retiring after September 12, 2006 will have a 7.5% increase in their annual grant for each year that they retire after age 60
- Encourages current workforce to stay longer, thus increasing the funding period for the pension plan (experience study modifications through behavior changes)

Employee Concessions

- The 1 percent payroll deduction for retiree health care transferred toward payment of increased retroactive pension plan Unfunded Actuarial Accrued Liability (UAAL) due to change in behavior (retiring at 55 versus 65)
- The lump sum benefit upon termination to be phased out (ten-year period)
- Splitting the pool, effective January 2008

Employee Concessions

- Employees retiring after September 12, 2006 will have a 7.5% reduction in their annual grant for each year that they retire before age 60
- Accept increases in normal cost employee contributions to the pension plan

Retiree Concessions

- A split pool effective January 2008 (employees insurance premiums segregated from retiree premiums, thus ending a long-time subsidy)
- Reduce the maximum annual cost of living adjustment (COLA) from 3% to 5%
- Reduce the grant by 50% once the retiree becomes Medicare eligible (applies to those 64 and younger)

Results of Negotiations

- The UAAL is reduced from $1.4 billion to approximately $598 million
- The ARC is reduced from $130 million, 11.5% of payroll to 3.0-3.5% of payroll
- A positive reaction from the rating agencies, who love “plans”
- Only one bargaining unit that has not yet concurred (could revert up to 5.4% of payroll)
- A potential lawsuit from the retirees

Conclusion

- Provide fair Post Employment Benefits to our workforce
- Protect the financial integrity of the employer
- Start reducing unfunded liabilities now, so that legacy costs are not saddled on our children and grandchildren
- Avoid taxpayer disconnect (as they want reforms)

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