August 27, 2012

The Honorable Richard J. Loftus, Jr.
Presiding Judge
Santa Clara County Superior Court
191 North First Street
San Jose, CA 95113

RE: Grand Jury Report: An Analysis of Pension and Other Post Employment Benefits

Dear Judge Loftus:

At the August 21, 2012 meeting of the County of Santa Clara Board of Supervisors (Item No. 20), the Board adopted the response from the County Administration to the Final Grand Jury Report and recommendations relating to An Analysis of Pension and Other Post Employment Benefits.

As directed by the Board of Supervisors and on behalf of the Board President, our office is forwarding to you the enclosed certified copy of the response to the Final Grand Jury Report. This response constitutes the response of the Board of Supervisors, consistent with provisions of California Penal Section 933(c).

If there are any questions concerning this issue, please contact our office at 299-5001 or by email at lynn.regadanz@cob.sccgov.org.

Very truly yours,

LYNN REGADANZ
Interim Clerk, Board of Supervisors
County of Santa Clara

Enclosures
August 7, 2012

To: Gary Graves  
Chief Operating Officer

From: Luke Leung  
Deputy County Executive

Subject: Response to Santa Clara County Grand Jury Report — An Analysis of Pension and Other Post Employment Benefits

This memo is in response to the June 13, 2012 Santa Clara County Grand Jury Report — An Analysis of Pension and Other Post Employment Benefits. It should be noted that throughout the report, the County of Santa Clara and the cities and towns within are collectively referred to as City or Cities.

The findings, recommendations, and the County’s responses are as follows:

Finding 1: Public sector employees are eligible for retirement at least 10 years earlier than is common for private sector employees.

Recommendation 1: The Cities should adopt pension plans to extend the retirement age beyond current retirement plan ages.

County Response: Agree as to Finding 1. However, the recommendation requires further analysis and discussion between County Administration and the Board of Supervisors as such a change (i.e. through switching to a lesser retirement plan formula like 2%@60 for Miscellaneous or 3%@55 for Safety) would be subject to successful collective bargaining with the County’s employee organization groups and would require that these groups all agree to such a change within their respective CalPERS membership category. It is also important to note that under current CalPERS rules, such a change would only be allowed as a second tier plan change affecting new hires only and cannot be applied to existing current employees. (See Board of Supervisors below to Recommendation 2A).

Extending the retirement age is just one of several possible pension plan changes that could be considered, but which need to be discussed together with other potential benefit and contract changes for collective bargaining; therefore a full discussion of...
the various options and alternatives to be negotiated needs to occur before direction and priority for specific pension plan changes can be provided. It is expected that this discussion will occur within the next six months as negotiations with the majority of the bargaining groups will begin shortly after the start of the new calendar year.

**Finding 2:** Campbell, Gilroy, Los Altos Hills, Los Gatos, Milpitas and Palo Alto have adopted second tier plans that offer reduced Benefits, which help reduce future costs, but further changes are needed to address today's unfunded liability. Santa Clara County and the cities of Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga and Sunnyvale have not adopted second tier plans.

**Recommendation 2A:** Santa Clara County and the cities of Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga and Sunnyvale should work to implement second tier plans.

**County Response:** Agree as to Finding 2. However, the recommendation requires further analysis and discussion between County Administration and the Board of Supervisors as such a change would be subject to successful collective bargaining with the County's employee organization groups and would require that these groups all agree to such a change within their respective CalPERS membership category (Miscellaneous or Safety).

It should be noted that during the recent round of collective bargaining for Fiscal Year 2011-2012 which included the majority of bargaining groups, the County proposed second tier plans to each of the groups within their respective CalPERS membership category. The second tier plan proposal included changing to a reduced benefit plan formula (i.e. lower benefit percentage and/or higher normal retirement age) and returning to the highest three-year salary compensation for calculating pension.

Unfortunately, the County was not successful in getting agreement for these changes from its bargaining groups with the exception of one of the Safety bargaining groups. However, under current CalPERS rules, an employer is not allowed to have separate pension formulas for their individual bargaining groups and therefore the County could not move ahead with implementing a second tier plan for the one Safety group until all of the other Safety bargaining groups agree to the second tier plan or until CalPERS changes its rules to allow for separate contracts for individual bargaining groups. (The same rules apply for the Miscellaneous bargaining groups.)

Negotiations have recently begun with the remaining Safety bargaining groups, which the County is hoping to get agreement for a second tier plan, but there is no guarantee. If successful, this may help to spur the other groups to agree as well and allow the County to move forward with implementation.

Also, since the County contracts with CalPERS for the pension plan benefits provided to its employees, any second tier plan that offers reduced benefits are limited to the plan options currently available through CalPERS.
Recommendation 2B: For Gilroy, Los Gatos, Milpitas and Palo Alto, which have not implemented second tier plans for Misc and Public Safety second tier plans should be implemented for both plans.

**County Response:** Not applicable

Recommendation 2C: All Cities' new tier of plans should close the unfunded liability burden they have pushed to future generations. The new tier should include raising the retirement age, increasing employee contributions, and adopting pension plan caps that ensure pensions do not exceed salary at retirement.

**County Response:** Agree as to Finding 2. However, the recommendation requires further analysis and discussion between County Administration and the Board of Supervisors as such changes like raising the retirement age (through switching to a less generous benefit plan formula) would be subject to successful collective bargaining with the County's employee organization groups and would require that these groups all agree to such a change within their respective CalPERS membership category (Miscellaneous or Safety). (See County Response on 2A).

Other changes like increasing employee contributions are not limited to second tier plans and to new hired employees only. In fact, during the recent round of collective bargaining for Fiscal Year 2011-2012, the County was successful in negotiating with a majority of its bargaining groups increased employee contributions for existing and new hired employees toward the County's employer cost share portion of pension contributions. Additional negotiations with the remaining bargaining groups are underway and the County expects to get similar agreement for increased employee contributions from all employee groups over the course of the next year as each bargaining group contract comes up for renegotiation.

Regarding adoption of pension plan caps that ensure pensions do not exceed salary at retirement, it is important to note that the County does not have the ability to implement such caps since the County contracts with CalPERS for its retirement pension plan and are bound by the CalPERS rules that are currently in place. So unless CalPERS changes these rules, the County cannot implement this part of the recommendation even if its bargaining groups agreed to it.

Finding 3: Retroactive Benefit enhancements were enacted by Cities using overly optimistic ROI and actuarial assumptions without adequate funding in place to pay for them.

Recommendation 3: The Cities should adopt policies that do not permit Benefit enhancements unless sufficient monies are deposited, such as in an irrevocable trust concurrent with enacting the enhancement, to prevent an increase in unfunded liability.

**County Response:** Disagree partially with Finding 3. The County agreed to benefit enhancements based on the best actuarial cost information that was provided by
CalPERS to the County at the time enhancements were being considered and negotiated with the bargaining groups. The County relied on those CalPERS actuarial estimates as the required contribution amounts that the County's employees would have to pay in order to cover the cost of the benefit enhancements. In hindsight, the ROI and the actuarial assumptions provided from CalPERS have turned out to be overly optimistic particularly as a result of the economic downturn and the huge stock market losses during the past decade. But neither CalPERS nor the County would have predicted the extreme volatility of the ROI during this period at the time the benefit enhancements were added. Furthermore, under CalPERS rules, any benefit enhancements that were to be added were required to be applied retroactively to the employees' total service with the County including all service time prior to the benefit change.

The recommendation to adopt policies that do not permit future benefit enhancements unless sufficient monies are deposited in an irrevocable trust, concurrent with enacting the enhancement to prevent an increase in unfunded liability, makes sense. In fact, the current legislation requires that the future annual costs of any benefit changes and the impacts of such changes on future unfunded liability be presented in a public meeting before any benefit changes can be adopted. Furthermore, an enrolled actuary must be present at the public meeting where the benefit changes are to be considered to provide information as necessary. Adopting a policy which requires that adequate funds are set aside to prevent an increase in unfunded liability for any benefit enhancements is consistent with the accountability and transparency requirements of the current legislation. The preparation of the policies for adoption has not yet been implemented, but is expected to be implemented within the next 6 months.

Finding 4: The Cities are making an overly generous contribution toward the cost of providing Benefits.

Recommendation 4A: The Cities should require all employees to pay the maximum employee contribution rate of a given plan.

County Response: Agree as to Finding 4. However, the recommendation requires further analysis and discussion between County Administration and the Board of Supervisors as such a change would be subject to successful collective bargaining with each of the County’s employee organization groups and would require that these groups all agree to such a change.

Additionally, as noted earlier, potential pension plan changes like increasing employee contributions to the maximum member rate of a given plan must be considered together with other possible benefit changes and negotiable terms; therefore a full discussion of the various options and alternatives needs to occur before direction and priority for bargaining can be provided. It is expected that this discussion will occur within the next six months as negotiations with bargaining groups will begin shortly after the start of the new calendar year.
Recommendation 4B: The Cities should require employees to pay some portion of the Past Service Cost associated with the unfunded liability, in proportion to the Benefits being offered.

County Response: Agree as to Finding 4. However, the recommendation requires further analysis and discussion between County Administration and the Board of Supervisors as such a change would be subject to successful collective bargaining with each of the County's employee organization groups and would require that these groups all agree to such a change.

It is uncertain though whether CalPERS would be able to readily calculate what portion of the past service cost associated with the unfunded liability was derived from the benefit enhancements that were added over the past 10+ years. Furthermore, employees have been making additional employee contributions that were negotiated at the time of the enhancements to pay for these added benefits based on the earlier CalPERS actuarial estimates.

As noted earlier, any additional employee contributions required must be considered together with other possible benefit changes and negotiable terms; therefore a full discussion of the various options and alternatives needs to occur before direction and priority for bargaining can be provided. It is expected that this discussion will occur within the next six months as negotiations with bargaining groups will begin shortly after the start of the new calendar year.

Finding 5: The Cities are not fully funding OPEB benefits as evidenced by large unfunded liabilities and small funded ratios.

Recommendation 5: The Cities should immediately work toward implementing policy changes and adopting measures at making full OPEB ARC payments as soon as possible.

County Response: Partially agree as to Finding 5. Prior to this recommendation, the County had previously set aside funding from about 1999 to 2006 to be used toward prefunding OPEB liabilities. In 2008, the County contracted with the California Employers Retirement Benefit Trust (CERBT) which was administered by CalPERS and began making full OPEB ARC payments for the first year and a half following the establishment of the CERBT. Unfortunately, as a result of the economic downturn and recession that followed over the next few years, the County was faced with significant budget deficits and could not continue to make full OPEB ARC payments to the CERBT. The County is trying to move back toward making full ARC payments. However, achieving full ARC payments will require a significant increase in funding and/or major changes to retiree medical plan design and employee contribution requirements to help reduce the ARC. In addition, such a policy change will need to be considered together with prioritization of available long-term resources and maintaining critical services to the community. It is expected that this
discussion will occur within the next six months as budget preparation and negotiations with the majority of the bargaining groups are expected to begin again shortly after the start of the new calendar year.

Finding 6: The City of San Jose permits the transfer of pension trust fund money, when ROI exceeds expectations, to the SRBR, despite the fact that the pension trust funds are underfunded.

Recommendation 6: The City of San Jose should eliminate the SRBR program or amend the SRBR program to prevent withdrawal of pension trust money whenever the pension-funded ratio is less than 100%.

County Response: Not Applicable

Finding 7: The Cities defined benefit pension plan costs are volatile. Defined contribution plan costs are predictable and therefore more manageable by the Cities.

Recommendation 7: The Cities should transition from defined benefit plans to defined contribution plans as the tier plans are implemented.

County Response: Agree as to Finding 7. However, the recommendation will not be implemented because it is not warranted or reasonable to abandon the defined benefit plan for a defined contribution plan without further attempts to negotiate and make any number of pension reform changes that could help to stabilize and sustain the defined benefit plan over the long term. Many of these changes are either already under consideration as part of the Governor's 12 Point Pension Reform Plan and/or potentially to be included as part of the County's next round of collective bargaining priorities.

Defined contribution plans have been negatively affected (just as defined benefit plans have) by the same market forces over the past few years that have placed many employees and retirees in financial jeopardy. While it is critical that the risk of these losses is not borne solely on the employer and ultimately to the taxpayer, there are options and alternatives to reducing the risk and they should be fully explored before considering making a change to a defined contribution plan.

Defined benefit plans play an important role in providing a certain level of retirement security for not only public sector employees but also for private sector employees. They are an essential benefit to recruiting and retaining quality employees particularly for the public sector.

c: Jeff Smith, County Executive