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December 18, 2012

Marin County Board of Supervisors
3501 Civic Center Drive
San Rafael, CA 94903

SUBJECT: Informational Update on State Pension Reform

Dear Supervisors,

RECOMMENDATION
Accept Report and Approve Next Steps to 1) Explore Employee Option Hybrid Plan, and 2) Adopt 5-Year Policy to Dedicate New Tier Normal Cost Savings toward Paying Down the County's Existing Unfunded Liability

OVERVIEW
The California Public Employees' Pension Reform Act of 2013 (PEPRA) was approved by the Legislature in September. PEPRA was authorized with passage of AB 340 (Furutani) and will change public employee retirement plans starting January 1, 2013. In addition, the legislature passed AB 197 (Buchanan), which clarifies what is considered 'compensation earnable' for current members.

Although PEPRA does not create a lower cost hybrid plan for new employees, it does achieve several of your Board's pension reform goals - such as equal sharing of normal costs for new employees; limits on pension spiking; less costly pension benefit levels for new employees; and a pension benefit cap. Some of the more significant reform provisions of PEPRA include:

- A cap on the amount of compensation that can be used to calculate a retirement benefit for new members equal to 120% of the Social Security wage index limit for employees who do not participate in Social Security ($136,440 effective January 1, 2013);
- New/lower pension tiers requiring additional years of service, specifying that the retirement formula for the (defined benefit) DB plan will be 2.0% at age 62 for all new non-safety employees, up to 2.5% at 67, and a 2.7% at age 57 formula for new safety employees;
- Contributions from new employees to the DB plan equal to one-half of the normal cost of the DB;
- Authorization for counties to negotiate cost sharing agreements that include the costs of unfunded pension liability;
- Elimination of pension spiking for new employees with a strict definition of "pensionable compensation" that excludes items such as vehicle allowance, uniform allowance, and employer contributions to defined benefit plans; and

- Restriction in the use of retired annuitants by prohibiting a retiree from returning to service before 180 days has passed (excluding public safety officer or firefighter retirees) - unless the employer certifies the appointment is necessary to fill a critically needed position and the appointment is approved by the governing body of the employer in a public meeting.

What follows is a report on the estimated savings to the County of PEPRA, a discussion of whether becoming a Charter County would help reduce our pension costs, and recommended next steps in our pension reform efforts.

ESTIMATED FISCAL IMPACTS

There are three general categories of cost savings that should be realized in the County as a result of PEPRA, including (1) lower normal costs as a result of the lower tiers; (2) greater employee cost sharing of normal costs; and (3) limiting pensionable earnings to prevent pension "spiking."

Generally speaking, the estimated annual savings is small initially, but will substantially increase over the long term. Specifically, on a cumulative basis, we estimate new tier savings of approximately $10.6 million over 10 years and approximately $41.3 million over 20 years. To the extent we are able to negotiate equal normal cost sharing for existing employees, we would save an additional $4 million per year.

Lower Normal Costs – New Tier Savings

Working with Bartel and Associates, our contract actuary, initial estimates of the fiscal impact of the benefit formula changes for new Marin County employees indicate a total normal cost employer contribution rate savings of approximately 1.7% of payroll for new employees. Normal cost is the annual percentage of total payroll that must be contributed to fund the promised benefit attributable to the current year of service; it does not include the unfunded actuarial accrued liability. Although the benefit formula changes overall for both new miscellaneous and safety employees result in small savings initially, the savings will grow significantly over the long term as new hires after January 1, 2013 replace exiting workers.

It is estimated that the County's annualized savings will be approximately $200,000 in the first full year; approximately $1.0 million in year 5; $2.0 million in year 10; and $4.0 million in year 20. On a cumulative basis, the estimated savings is approximately $3.0 million after 5 years; $10.6 million after 10 years; and $41 million cumulatively after 20 years. See Attachments A-B for a graphical and tabular representation of the estimated annual and cumulative savings over 20 years in 5 year increments.

These estimated savings are due largely to a combination of the lower normal costs for new employees of the lower benefit tiers and the benefit cap of 120% of the Social Security wage index ($136,440 effective January 1, 2013).

50/50 Sharing of Normal Costs – New Employee Contributions
New employees will be required by PEPRA to contribute at least 50% of the normal cost of their retirement benefit, and employers will not be permitted to pay those contributions for employees. Currently the County contributes 2% of salary for miscellaneous employees and 3% for sworn employees. PEPRA states that for new employees the County's contribution will go away upon renewal or extension of current bargaining agreements.

Annually the County spends approximately $4 million per year toward employee pension contributions. Once our labor agreements have expired, we estimate that we would save approximately $120,000-$200,000 annually depending on the level of attrition since these payments would not be required for new employees.

While we have the opportunity under PEPRA to negotiate a 50/50 sharing of normal costs with current employees, that sharing could not be imposed until January 1, 2018. The statute also contains percentage limits of employee sharing above the otherwise applicable normal cost rate.

Reductions in Pensionable Compensation for New Employees
For all new employees, PEPRA would restrict the pay categories that are eligible to be pensionable. While MCERA will retain the authority to determine "pensionable compensation" per PEPRA, it is anticipated that the following payments will not be pensionable for new members as of January 1, 2013:

- Employer provided allowances like housing, auto or uniform;
- Any payments for unused vacation, annual leave, personal or sick leave, or compensatory time off, regardless of when it was reported or paid;
- Separation payments paid in connection with termination from employment;
- Payment for services rendered outside of normal working hours, including compensation for overtime, other than FLSA for employees in fire protection activities or law enforcement;
- Employer contributions to deferred compensation or defined contribution plans, such as a 457(b) plan;
- One-time or ad hoc payments;
- Bonuses paid in addition to base pay;
- In-kind benefits being converted to cash payments during a member's final average compensation period; and
- Any other compensation the Retirement Board determines should not be pensionable compensation.

While the definition of "pensionable compensation" for new employees should result in additional savings, we are not able to estimate these savings at this time since 1937 Act systems statewide, including MCERA, are considering what pay types are applicable at the time of this staff report.

CHARTER COUNTY STATUS AND RETIREMENT ISSUES

In recent months, some have questioned whether the County could adopt a County Charter with its own unique pension provisions in lieu of continued sponsorship within the Marin County Employee's Retirement Association (MCERA) authorized in statute under the 1937 Act. In short, becoming a charter county would not change our pension liabilities for existing employees - and existing State law does not allow the County to opt out of MCERA.

Some cities such as San Jose, San Francisco and San Diego are charter cities with charter pension systems. Because their pension systems were established by their voters, their voters can make changes to their systems. These changes are still subject to legal challenge, however.

Under current law, there is not a mechanism to opt out of MCERA. In addition, changing our retirement system would still be subject "meet and confer" requirements, and any modifications would be subject to vested rights laws.

RECOMMENDED NEXT STEPS

Explore Employee Option Hybrid Plan

Consistent with your Board's Pension Reform Policy Guidelines, we are recommending that staff explore a hybrid defined benefit (DB)/defined contribution (DC) plan for new miscellaneous employees. In terms of next steps, this would require work with an actuary to create hybrid options; agreement with our bargaining units; and legislation to establish the legal authority to implement the new employee option hybrid plan.

Over the long term, we believe this direction would better fit the next generation of workers by providing greater portability while sharing market risk. Again, any potential new option would be subject to agreement with our collective bargaining units and would require new authorizing legislation before it could be implemented.

Adopt Policy to Dedicate PEPRA Savings to Paying Down Existing Unfunded Liability

To further your Board's policy direction to accelerate payments toward our unfunded pension liability, we recommend that your Board direct that PEPRA savings associated with the new benefit tiers and benefit cap be dedicated toward further paying down the County's unfunded pension liability for the next five years. <u>According to our actuary, it is estimated that this policy would contribute approximately $3.0 million to our unfunded liability over the next five years.</u>

For reference, the County's funded ratio was 74.2% as of MCERA's June 30, 2011 valuation. We anticipate that your Board's previous direction to pay down $32 million of our current unfunded pension liability this fiscal year will improve our funded ratio to approximately 76.4% (all else remaining the same). Utilizing PEPRA savings over the next five years to further pay down the County's unfunded pension liability should further increase the County's funded ratio.

Should you have any questions, please feel free to contact me.

Sincerely,

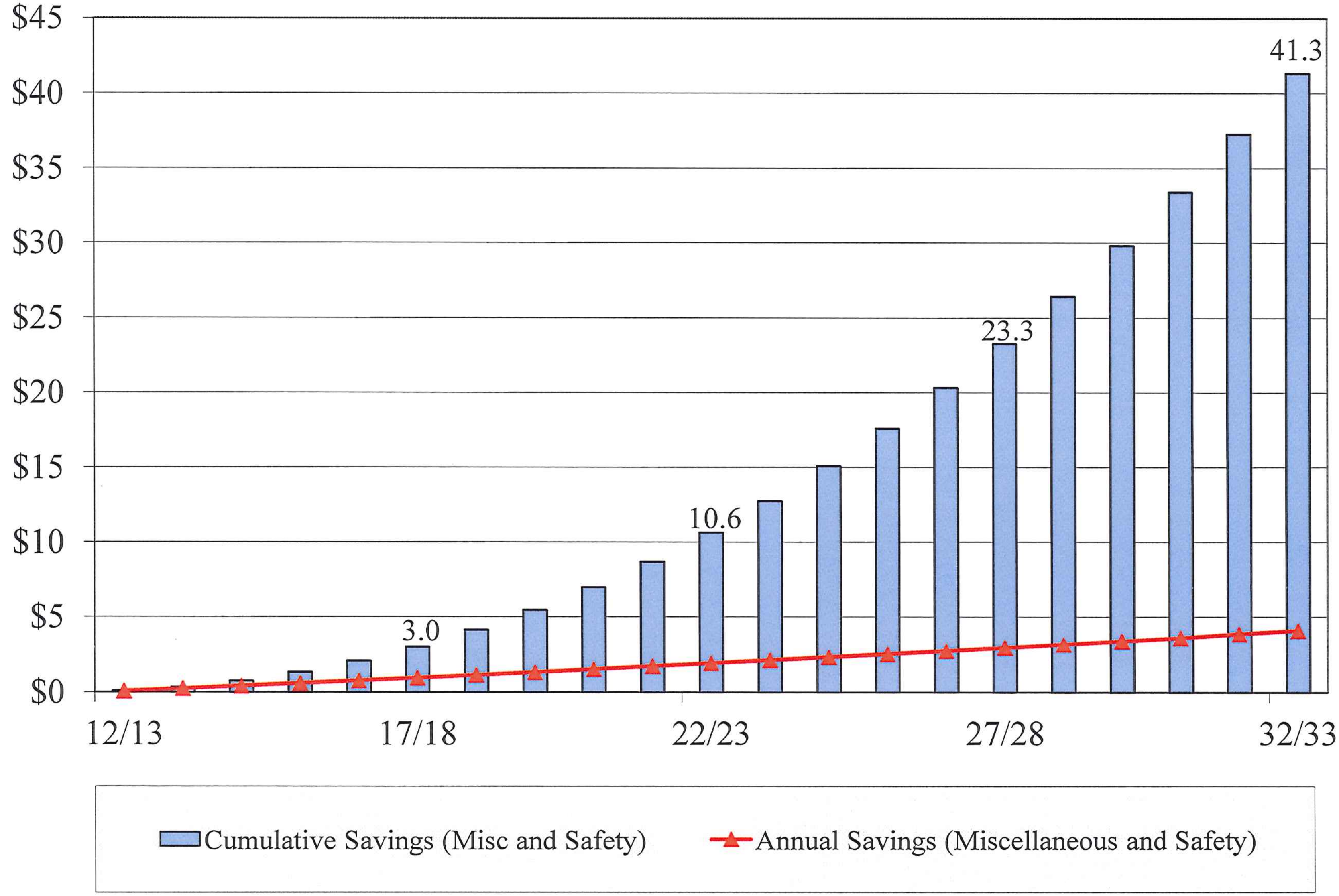
Daniel Eilerman
Deputy County Administrator

Reviewed by,

Matthew H. Hymel
County Administrator

Attachment A

County of Marin
MCERA 20 Year PEPRA Savings Projection
Totals



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County of Marin: Estimated 20-Year Savings for PEPRA Benefit Formulas

(amounts in millions)

Miscellaneous and Safety (PEPRA formula 1/1/2013)

	Estimated Payroll for FY		Contribution Rate Savings	Savings in Fiscal Year		
Fiscal Year	Total	Hired after 12/31/2012*	Hired after 12/31/2012	% of Total Payroll	$'s**	Cumulative Savings $'s
2012/13	$149.7	$4.7	1.64%	0.05%	$0.08	$0.08
2017/18	171.1	56.7	1.65%	0.55%	0.94	3.01
2022/23	200.8	115.8	1.66%	0.96%	1.92	10.63
2027/28	235.6	176.8	1.66%	1.25%	2.94	23.27
2032/33	276.5	244.8	1.67%	1.48%	4.08	41.33

Miscellaneous Employees (PEPRA formula 1/1/2013)

	Estimated Payroll for FY		Contribution Rate Savings	Savings in FY		
Fiscal Year	Total	Hired after 12/31/2012	Hired after 12/31/2012	% of Total Payroll	$'s	Cumulative Savings $'s
2012/13	$114.1	$3.8	1.60%	0.05%	$0.06	$0.06
2017/18	129.7	44.3	1.60%	0.55%	0.71	2.27
2022/23	152.2	88.9	1.60%	0.93%	1.42	7.95
2027/28	178.6	134.2	1.60%	1.20%	2.15	17.22
2032/33	209.6	184.8	1.60%	1.41%	2.96	30.33

Safety (PEPRA formula 1/1/2013)

	Estimated Payroll for FY		Contribution Rate Savings	Savings in Fiscal Year		
Fiscal Year	Total	Hired after 12/31/2012	Hired after 12/31/2012	% of Total Payroll	$'s	Cumulative Savings $'s
2012/13	$35.6	$0.9	1.81%	0.05%	$0.02	$0.02
2017/18	41.4	12.5	1.85%	0.56%	0.23	0.74
2022/23	48.6	26.8	1.86%	1.03%	0.50	2.68
2027/28	57.0	42.6	1.87%	1.40%	0.80	6.05
2032/33	66.9	60.0	1.87%	1.68%	1.12	11.00

* And subject to PEPRA

** Miscellaneous + Safety savings is estimated to be $80,000 from 1/1/2013 to 6/30/2013 and $200,000 for 2013 calendar year.

County of Marin: Estimated 20-Year Savings for PEPRA Benefit Formulas

(amounts in millions)

Notes:

1. Figures are rough estimates based on the assumptions and data used in the June 30, 2011 actuarial valuation of the retirement system.
2. Contribution rate savings are shown as a percentage of payroll limited to the PEPRA wagebase.
3. Plan change only applies to employees hired after December 31, 2012 and not entitled to reciprocity for pre-PEPRA service.
4. Initially assume 10% of new hires have reciprocity for pre-PEPRA service, decreased to 0% over 20 years to reflect fewer reciprocities transferring with pre-PEPRA service.
5. Does not include PEPRA increased disability benefit which could reduce Safety savings by 0.3% to 0.4% of payroll.
6. First pay increases occur 1/1/2014 for Fire, 7/1/2014 for all others.