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February 5, 2013

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

SUBJECT: Other Post-Employment Benefits (OPEB) Trust Agreement with California Employers' Retiree Benefit Trust (CERBT)

Dear Supervisors,

RECOMMENDATION

1. Adopt resolution and agreement with California Employers' Retiree Benefit Trust Program ("CERBT") electing the County of Marin to prefund Other Post-Employment Benefits through CalPERS;
2. Approve budget adjustments and expenses as detailed in staff report to contribute up to $26.3 million to the County of Marin's OPEB Trust during the 2012-13 fiscal year;
3. Adopt resolution delegating to the County Administrator and the Director of Finance authority to request disbursements on behalf of the County from the Other Post Employment Prefunding Plan and to certify as to the purpose for which the disbursed funds will be used; and
4. Authorize the County Administrator to execute any legal and administrative documents on behalf of the County; to take whatever additional actions are necessary to maintain the County's participation in the CERBT Program; to maintain compliance with any relevant regulation issued or as may be issued for the Program; and to take whatever additional actions are required to administer the County's CERBT plan with CalPERS.

Overview

As part of our FY 2012-13 adopted budget, your Board directed staff to establish a retiree health trust this fiscal year. We have worked with Bartel Associates, LLC to help determine the appropriate annual contributions required to pay for our unfunded retiree health liabilities over a 30 year period.

One of the benefits of creating a trust would not only be to set money aside but to also earn a higher investment return on these funds. The County's July 1, 2011 OPEB actuarial valuation included a 4.25% discount rate – which can be thought of as an expected rate of return. The creation of an OPEB trust would allow the County to assume a higher discount rate of 5.0% to 7.0% depending upon tolerance for market risk and the County's required cash flow

for future benefits. To remain conservative and to be mindful of our longer term cash flow requirements, we are recommending a 5.5% discount rate.

Given the size of the potential investment, the County contracted with SST Benefits Consulting to assist with a Request for Proposals (RFP) for potential providers of an OPEB Trust to ensure a broad-based and effective RFP process with competitive proposals. Ten potential respondents were invited to consider and respond to the County's RFP, and the RFP was advertised on the County's website as well as on SST's website.

An RFP committee was established to work with the consultants to create the RFP; review the responses; and to recommend a finalist to your Board. The committee included Roy Given, Director of Finance; Joanne Peterson, Director of Human Resources; Jack Govi, Assistant County Counsel; Jeff Wickman, Marin County Employees' Retirement Association (MCERA) Administrator; Matthew Hymel, County Administrator; and Dan Eilerman, Deputy County Administrator.

The County ultimately received four RFP responses, including the California Employers' Retiree Benefit Trust (CERBT under CalPERS); Public Agency Retirement Services (PARS); ICMA Retirement Corporation in concert with Vanguard Investment Advisory Services (ICMA/Vanguard); and Public Financial Management, Inc. (The PFM Group).

Recommendation: CalPERS California Employers' Retiree Benefit Trust (CERBT) Program

We are recommending establishing an Other Post-Employment Benefits (OPEB) Trust with the Cal-PERS California Employers' Retiree Benefit Trust (CERBT) Program for a period of three years. After reviewing all of the responses, requesting additional and clarifying responses from three finalists, and holding finalist interviews December 17, 2012 among representatives from CalPERS, ICMA/Vanguard and PARS, the committee is recommending CalPERS' CERBT Program as the best fit for the County's needs at this time.

CalPERS' CERBT Program includes more than 340 California public employers with $2.3 billion of employer assets to pre-fund approximately $14 billion of employer OPEB liabilities. It is the largest multiple-employer OPEB trust fund in California, with 13 California counties as clients – including four of our comparison counties (Napa, Monterey, San Luis Obispo, and San Mateo).

Consistent with Governmental Accounting Standards Board (GASB) Statement 45, funds contributed to the trust are irrevocable and are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan. Your Board does, however, have the ability to choose another alternate OPEB trust provider in three years at the end of our proposed agreement with CalPERS.

The County anticipates for at least the first several years to contribute funds to – not disburse funds from – the OPEB trust. Since the County is focused initially on growing an asset base, the County's ideal provider is one with competitive investment performance at low cost and with uncomplicated administrative procedures.

While ICMA/Vanguard and PARS submitted competitive responses, CalPERS CERBT program offered the most competitive proposal with the lowest "all in" investment and management fees at 19 basis points, streamlined administrative procedures, and competitive investment performance (please see Attachment A for CalPERS Performance Summary Report through November 30, 2012.)

Attachment B summarizes proposed investment and management fees among the three finalists. While CalPERS proposed a 19 basis point "all in" fee structure regardless of the amount invested, both ICMA/Vanguard and PARS fees were dependent upon the amount of funds invested – with additional service and transactions fees applying as well. The County would have to invest over $100 million with ICMA/Vanguard in its passively managed portfolio to achieve investment and management fees comparable to CalPERS' 19 basis points fee proposal. The County would have to invest over $50 million to achieve PARS' least expense fee proposal of 64 basis points.

PARS and ICMA/Vanguard offer more flexibility and customized investment approaches, which the County may find in the future to be of added value considering our employee demographics and future cash flow needs over a 30 year period. As the County in the future will begin to withdraw funds from the trust to pay medical premium costs for our retirees, we will want to consider a more conservative investment strategy to ensure sufficient funds are available for these obligations to meet our projected cash flow needs. The County would likely RFP for services again, for which we would again invite PARS, ICMA/Vanguard and other private firms or consortiums to bid for the County's services at that time.

In the near term, however, the County's interests are more focused on establishing and growing an initial asset base with low investment and management expenses that will outperform the County's current ability to earn interest and dividends on funds held in the County Treasury with its more conservative investment policy. It is important to note that the selection of CalPERS CERBT as the County's OPEB Trust provider binds the County for only three years. The County can consider a trustee-to-trustee transfer at any point after the initial three year commitment to an alternative provider.

CERBT Asset Allocation Strategy No. 2 Recommended

With an initial interest in growing an asset base for some number of years, we are recommending a moderate risk asset allocation. As our cash flow needs

change, we will be recommending a more conservative investment strategy once we start relying on withdrawing trust funds to fund our liabilities. Because of this, we are recommending a 5.5% discount rate over the 30 year period of our OPEB trust. The use of a discount rate that differs from MCERA's 7.50% is necessary because of different cash flow needs to cover the retiree health liabilities over a 30 year period with a closed (declining) amortization period.

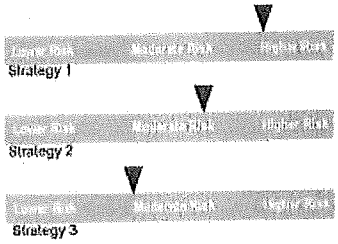
CalPERS CERBT offers three asset allocation strategies, each of which offers different expected long term investment returns and return volatility. The three strategies use the same underlying set of asset classes, but differ to the extent they participate in their respective asset classes. Strategy 1 assumes a discount rate of 7.61%; Strategy 2 assumes 7.06%; and Strategy 3 assumes 6.39%. Asset class target allocations are summarized below:

CERBT Strategy Risk Levels

CalPERS offers employers the choice of one of three investment strategies. Risk levels among strategies vary, depending upon the target asset class allocations. Generally, equities carry more risk than fixed income securities.

Asset Class Target Allocations*	Strategy 1	Strategy 2	Strategy 3
Global Equity	66%	50%	32%
U.S Fixed Income	18%	24%	42%
TIPS	5%	15%	15%
REITs	8%	8%	8%
Commodities	3%	3%	3%

*CalPERS is transitioning toward these strategic asset allocation mixes. The process was initiated in September 2011 and is expected to be completed in the autumn of 2012



Given the County's desire to grow an asset base for some number of years without making any distributions, the RFP Committee is recommending Strategy 2 with a discount rate of 7.06% as a 'moderate risk' asset allocation balance between increased investment returns without the higher equity risk of Strategy 1 and the likely lower returns of the more conservative Strategy 3.

However, because the County's budget assumes a 5.50% discount rate to help close this year's budget shortfall, we are recommending that the County assume a 1.56% "margin for adverse deviation" for a net discount rate assumption of 5.50% with the CalPERS CERBT program. A margin for adverse deviation allows the County to assume more conservatism actuarially than is offered by CalPERS' three allocation strategies without forgoing the higher equity allocation of Strategy 2 that would be expected to generate greater investment returns over time, albeit with moderately more risk, consistent with our desire to grow an asset base in initial years.

The County's budget and OPEB actuarial valuation would rely upon a 5.50% assumed rate of return as a measure of conservatism despite the selection of the 7.06% discount rate and moderate risk asset allocation of Strategy 2. Selecting a margin for adverse deviation to net to a 5.50% assumed rate of return for actuarial and funding purposes at this time affords the best mix of

market growth in the initial years with the relative safety of more conservative actuarial assumptions over the long term.

Fiscal Impact
The County has $13.78 million reserved on its balance sheet on an all funds basis in Account 3121015 – Retiree Liabilities. In addition, the current year budget includes $12.50 million as a contingency in Account 9000000 among 12 budgeted funds for retiree health obligations, consistent with your Board's multi-year policy to set aside funds toward retiree liabilities.

As part of our recommended actions, we are requesting the necessary budget adjustments and transactions to transfer up to $26.3 million by June 30, 2013 in several installments via a 'dollar-cost average' investment strategy. Staff proposes four contribution dates of March 1, April 1, May 1 and June 3, 2013 in installments of approximately $6.5 million each for FY 2012-13 contributions.

Consistent with Governmental Accounting Standards Board (GASB) Statements 43 and 57, the County will prepare another OPEB valuation by November, 2013 effective for FY 2013-14 and FY 2014-15. Based upon your Board's approval to contribute $13.78 million from our reserves, we would expect a reduction in our required contribution of approximately $500,000 to $600,000 in FY 2013-14 (if our assumed investment earnings are met).

Please let me know if you have any questions or concerns.

Sincerely,

Daniel Eilerman
Deputy County Administrator

Reviewed by,

Matthew H. Hymel
County Administrator

Document Nos. 100018534; 100018535