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COUNTY OF MARIN

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Marin County Board of Supervisors
3501 Civic Center Drive
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SUBJECT: Informational Report on "The Pension Reform Act of 2014" ("The Reed Initiative") and Status Report on other Pension and Retiree Health Efforts

Dear Supervisors,

RECOMMENDATION

Accept Informational Report.

SUMMARY

On November 12, 2013, San Jose Mayor Chuck Reed—along with Mayor Patrick Morris of San Bernardino, Mayor William Kampe of Pacific Grove, Mayor Tom Tait of Anaheim, and Vice Mayor Stephanie Gomes of Vallejo—filed a new letter requesting that the California Attorney General (AG) prepare a circulating title and summary of the newly revised "The Pension Reform Act of 2014" (Reform Act)[1] – please see Attachment A for the letter and initiative language. The following is an initial review of the Reform Act as well as a brief update on our other pension and retiree health efforts.

OVERVIEW

The Pension Reform Act of 2014, if placed on the ballot and approved by a majority of voters, would amend the California Constitution to give government agencies added authority to negotiate changes to existing employees' pension or retiree healthcare benefits going forward. Pension reform has traditionally focused on altering benefits for new employees only, given court interpretation and rulings that pension benefits for existing employees are vested rights.

This initiative essentially stipulates that the retirement benefits that government employees have already earned are protected, but assumes that benefits for future years of service not yet worked may be modified. For example, an employee with 20 years of actual service may not have his/her benefits amended for that accrued service, but that same employee planning an additional 10 years of service before retirement may be subject to reduced benefits for that service not yet worked.

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[1] For the initial Reform Act, Mayor Miguel Pulido of Santa Ana withdrew his support. Vice Mayor Stephanie Gomes of Vallejo then added hers. The original Reform Act was withdrawn and a new version was re-submitted on November 12, 2013.

What follows is a high level overview of the Reform Act and its potential fiscal impacts, per the Legislative Analyst's Office (LAO); a brief discussion regarding the legal uncertainty surrounding the City of San Jose's voter-approved Measure B pension reform effort (which attempts to impact current City of San Jose employee benefits and inspired the statewide Reform Act); an update on Marin County pension reform efforts; and a staff recommendation regarding any potential position by your Board on "The Pension Reform Act of 2014."

A. Legislative Analyst's Office (LAO) Overview and Analysis

On December 19, 2013, the California Legislative Analyst's Office (LAO) submitted its fiscal impact analysis of the Reform Act to the Attorney General (AG). Following is a summary of the primary areas of proposed change and the LAO's estimated fiscal impacts. With a long history of non-partisan advice to the Legislature, we lean heavily upon the LAO's summary and estimated fiscal impacts for summary purposes:

Alters Automatic Vesting for Pension and Retiree Health Benefits for Future Service

Pension and retiree health benefits for future government employees would be earned and vested as the employee performs work and only in proportion to the work performed. Regarding current government employees, the measure specifies that their pension or retiree health benefits generally would be considered vested contractual rights only for work the employees have already performed.

Allows Employers to Reduce Pension and Health Benefits for Future Service

If a government employer finds its pension or retiree healthcare plan is substantially underfunded and is at risk of not having sufficient funds to pay benefits for retirees or future retirees, or declares a fiscal emergency, the employer would have the authority to implement one or more of the following for future service:

(1) Reduce the rate of accrual for benefits to be earned in the future,
(2) Reduce the rate of COLAs to be made in the future,
(3) Increase the retirement age for benefits earned in the future,
(4) Require employees to pay a larger share of the cost, or
(5) Make any other reductions or modifications agreed upon during collective bargaining.

Any of these changes would apply to future benefits and must be submitted to collective bargaining if any of the benefits are within the scope of collective bargaining. If good-faith efforts at negotiating, mediation, and/or fact-finding have been exhausted, the measure appears to permit employers to impose—to the extent permissible under collective bargaining laws for some groups of employees—the benefit changes summarized above under numbers one through four.

Requires Most Employers to Develop Pension and/or Retiree Health Care Funding Status Reports

The measure requires government employers to prepare a funding status report for any pension or retiree health plan with assets equaling less than 80 percent of its liabilities. The report must specify actions designed to fully fund the benefit plan within 15 years—including any changes in benefits or employer and employee annual costs. The government employer would be required to hold a public hearing on the funding status report (or reports) each year until the benefit plan's actuary finds that it is fully funded.

Restricts Pension Plan Administrator Authority in Certain Cases

The measure requires retirement plan administrators to use the same discount rate in their management of plans that have been modified, frozen, or terminated as they use for active plans. Pension boards could not use different discount rates to account for different asset allocations between plans.

Requires Employers With Terminated Plans to Make Annual Payments

The measure requires retirement plan administrators to establish contributions for employers with terminated plans using the same amortization schedule and other methodologies that govern the retirement plan administrator's other plans. This means that—instead of current practice where some terminating employers make a one-time payment of the unfunded liability calculated with a lower discount rate—terminating employers would make annual payments to the unfunded liability calculated with the same discount rate as other plans.

LAO's Summary of Fiscal Effects

According to the non-partisan Legislative Analyst Office (LAO), The Reform Act would result in the following major fiscal effects for both state and local governments:

- Potential net reduction of hundreds of millions to billions of dollars per year in state and local government costs. Net savings emerging over time would depend on how much governments reduce retirement benefits and increase salary and other benefits.
- Increased annual costs - potentially in the hundreds of millions to billions of dollars - over the next two decades for those state and local governments choosing to increase contributions for unfunded liabilities, more than offset by retirement cost savings in future decades.
- Increased annual costs to state and local governments to develop retirement system funding reports and to modify procedures and information technology. Costs could exceed tens of millions of dollars initially, but would decline in future years.

B. Status Update Regarding Progress of the Proposed Initiative

Signature gathering will be a challenge for proponents. 807,615 signatures will be required to get the measure on the November, 2014 ballot.

Proponents will have until mid-April to do so. To account for invalid signatures, proponents realistically would need to collect approximately 1.3 million signatures to ensure the required 807,615 valid signatures. It is also estimated that initiative proponents would need from $2.0-$4.0 million overall to obtain the required number of signatures to place the measure on November, 2014 ballot.

C. California Attorney General's Circulating Title and Summary

Attorney General Kamala Harris issued her formal title and summary for the initiative January 6, 2014 – please see Attachment B. Proponents and opponents objected to Harris' summary, with some proponents arguing that Harris favors opponents by consciously citing "teachers, nurses, and peace officers" to describe public employees given that these classes traditionally poll particularly well among the public as respected public employees. Some opponents objected that Harris did not adequately or prominently convey the extent to which pensions or retiree health care benefits would be cut or eliminated for public employees.

Initiative proponents are planning to file a lawsuit to challenge the language assigned by the Attorney General. It is anticipated by many that the litigation will force proponents to postpone the measure to November, 2016.

D. Legal Uncertainty Regarding City of San Jose's Measure B Initiative

For informational purposes, City of San Jose voters approved Measure B in June, 2012 to address the city's rising unfunded pension liability. The San Jose Police Officers' Association filed suit against the City to challenge "The Sustainable Retirement Benefits and Compensation Act," claiming that the Measure violates employees' vested rights. Court decisions have since invalidated key parts of San Jose's Measure, while upholding others.

Principally, Measure B called for existing employees to pay significantly more toward their pensions to help offset the City's unfunded pension liability. But a Santa Clara County Superior Court judge in December, 2013 invalidated that requirement - ruling that the city held responsibility for its unfunded liabilities and that employees have vested rights to their promised benefits.

Given that San Jose's Measure B can be viewed as the inspiration for the Reform Act now proposed for California voters' consideration, the judge's ruling raises questions about the constitutionality of the Reform Act's central premise – that of altering benefits for existing employees.

STAFF RECOMMENDS NOT TAKING A POSITION ON THE REED INITIATIVE AT THIS TIME

Consistent with our past practice, staff recommends that we monitor potential state ballot initiatives, but not take a position on them until it is

clear whether it will be on the ballot and if there are competing ballot measures that may also be on the ballot.

To take the most informed position, our office provides an overview of all state ballot initiatives for a particular election. After this overall review of all ballot measures, the Board indicates which measures they want to consider supporting or opposing as a full Board. We do not recommend taking a position regarding a ballot initiative before signatures are gathered and the proposal is qualified for the ballot by the Secretary of State. Initiatives can and do change subsequent to initial submission. Until signatures are gathered and the measure is qualified, it is not certain whether the voters will even consider the measure on Election Day. In addition, the Legislature can always put an alternative measure on the ballot. For these reasons, we recommend that your Board not take a position at this time.

E. Update on Marin County Pension Reform Efforts

We would like to also take this opportunity to provide your Board a brief update concerning our other pension and retiree efforts. In short, based on our actions over the past several years, we are making progress toward reducing our unfunded liabilities for pension and retiree health. Because of significant payments from reserves and better investment earnings, we expect significant decreases in our unfunded liability in both pension and retiree health.

Retiree Health Liabilities

Our actuary recently completed the County's Actuarial Valuation as of 7/1/2013 for our retiree health obligations. Our unfunded liability for retiree health has been reduced by $47.3 million since our last actuarial report in 2011. Specifically, the County's July 1, 2013 unfunded liability is estimated to be $335.4 million – down from $382.7 million per our last valuation two years ago through 7/1/2011.

With initial contributions of $26.3 million last fiscal year, the County's new retiree health trust has now earned $1.3 million on that investment through December 31, 2013 - for net assets of $27.6 million ending 2013. By establishing a retiree health trust, we have reduced our liabilities by over $1 million as compared to our previous practice of investing these funds within the County treasury.

Pension Liabilities

We also anticipate a reduction in the value of the County's unfunded pension liability as a result of the County's supplemental contribution of $32 million in 2013, as well as last year's 14.7% market performance (though 5-year actuarial smoothing will limit our gain on the market earnings, and it will also be offset by the 5th and last year of smoothed losses from 2008). We should also see improvement in the County's funded ratio. We do not expect to have MCERA's most recent actuarial valuation for 6/30/13 available until March.

In short, we're pleased to report we are making progress at reducing our long-term retiree unfunded liabilities. As you know, we have taken a number of additional actions to reduce our long-term liabilities over the past several years, including:

- Capping pension COLAs to 2.0% annually for new employees since 1980
- Requiring employees to pay 50% of the normal cost for any pension COLA's, and 50% of the cost for enhanced pension benefit formulas
- Using the average of the highest three years' earnings for pension calculations
- Adopting policy to dedicate Public Employee Pension Reform Act (PEPRA) savings for the first five years toward reducing the County's unfunded liability
- Capping the County's contribution to the employee's share of cost to 2% (for miscellaneous) and 3% (for safety) for employee pensions
- Contributing $32 million in one-time reserves in 2013 to pay down our unfunded pension liability – saving $2.4 million annually in employer costs beginning FY 2014-15
- Limiting growth in existing retiree health plans
- Establishing and contributing $26.3 million to a retiree health trust, adopting policy of paying for all our unfunded retiree health liabilities over the next 30 years
- Creating a $2 million retirement rate stabilization reserve in FY 2014

Exploring an Optional Hybrid Defined Benefit (DB)/Defined Contribution (DC) Plan

In addition, staff is currently evaluating an optional hybrid defined benefit (DB)/defined contribution (DC) plan for new miscellaneous employees, subject to agreement with collective bargaining units. Staff have been working with an actuary to cost the proposal, and will discuss this option with bargaining units in the spring with an update to your Board at that time.

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

Sincerely,

Daniel Eilerman
Deputy County Administrator

Reviewed by,

Matthew H. Hymel
County Administrator