CITY OF COSTA MESA
PENSION OVERSIGHT COMMITTEE

DATE: MAY 21, 2014

TO: CITY COUNCIL

FROM: PENSION OVERSIGHT COMMITTEE

CC: Brenda Green, City Clerk
Tom Hatch, CEO
Steve Dunivent, Finance Dir.
Kimberly Barlow, Esq.

SUBJECT: PROPOSE ADDING THE ATTACHED FINANCIAL ANALYSIS PROVISION TO THE MARCH 12, 2014 DRAFT CHARTER

Recommendation -

The Pension Oversight Committee (POC) recommends (by a vote of 7 to 0) that the City Council include a new provision, "Section 601. Financial Analysis" in the Charter (Attachment 1).

Background -

The POC reviewed California Government Code Section 7507 (Attachment 2).

Section 7507 states that cities, "when considering changing retirement benefits or other postemployment benefits shall secure the services of an actuary to provide a statement of the actuarial impact upon future annual costs, normal costs and additional accrued liability, before authorizing changes in such benefits."

Comments -

The POC believes Section 7507 is too general and has not provided adequate disclosure and transparency in the past. The Charter should enhance Section 7507's minimum standards to ensure a thorough and rigorous analysis is performed for the City Council, city management, and citizens. See further rationale in "Comments on Additional Impact Analysis" (Attachment 3).

The POC hopes our recommendation will be helpful to the City Council.

Jeff Arthur, Chair
Pension Oversight Committee

DRAFT CHARTER
MARCH 12, 2014

Section 600. Retirement Benefits.
On or after the effective date of this Charter, except for any increase previously authorized in a valid and binding memorandum of understanding or contract, no employee or officer of the City shall receive an increase in employee retirement benefits, other post-employment benefits, employer contributions for post-retirement benefits, including post-retirement health benefits, to be paid for by the City or for which the City is liable without approval by a two-thirds (2/3) majority of the voters at a general election.

PENSION OVERSIGHT COMMITTEE
<u>RECOMMENDS</u>
ADDING <u>SECTION 601</u> TO THE DRAFT CHARTER

Section 601. Financial Analysis.
Prior to the City Council authorizing a vote by citizens under Section 600, a "statement of the actuarial impact upon the City's future annual costs and accrued liability" of the proposed increase in Employee Retirement Benefits shall be prepared as required by law, including but not limited to an "additional impact analysis" of the following matters (collectively "Financial Impact Statement"):

- Annual financial impact for 30 years and risks to the City and its General Fund.
- Any changes in unfunded liability and reasons therefor.
- Any financial impact from retroactive application of benefits.
- Impact of future retirement fund earnings calculated at one percentage point above and below the actuarially projected earnings / discount rate.
- Present value of annual retirement benefits for a representative sample of employee positions.

At least two weeks prior to the City Council authorizing a vote by citizens, the "Financial Impact Statement" shall be posted and maintained through the election on the City's web site with the ability to be copied by the public. A summary of the findings from the Financial Impact Statement shall be made part of the City Attorney's "impartial analysis" required by law and included in voter information documents.

*** This document is current through Chapter 9 of ***
the 2014 Regular Session of the 2013-2014 Legislature.

GOVERNMENT CODE
Title 1. GENERAL
Division 7. Miscellaneous
Chapter 21. Public Pension and Retirement Plans
Article 1. General Provisions

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

Cal Gov Code § 7507 (2014)

§ 7507. Actuarial evaluations of future annual costs; Applicability

(a) For the purpose of this section:

(1) "Actuary" means an actuary who is an associate or fellow of the Society of Actuaries.

(2) "Future annual costs" includes, but is not limited to, annual dollar changes, or the total dollar changes involved when available, as well as normal cost and any change in accrued liability.

(b)

(1) Except as provided in paragraph (2), the Legislature and local legislative bodies, including community college district governing boards, when considering changes in retirement benefits or other postemployment benefits, shall secure the services of an actuary to provide a statement of the actuarial impact upon future annual costs, including normal cost and any additional accrued liability, before authorizing changes in public retirement plan benefits or other postemployment benefits.

(2) The requirements of this subdivision do not apply to:

(A) An annual increase in a premium that does not exceed 3 percent under a contract of insurance.

(B) A change in postemployment benefits, other than pension benefits, mandated by the state or federal government or made by an insurance carrier in connection with the renewal of a contract of insurance.

(c)

(1)

(A) With regard to local legislative bodies, including community college district governing boards, the future costs of changes in retirement benefits or other postemployment benefits, as determined by the actuary, shall be made public at a public meeting at least two weeks prior to the adoption of any changes in public retirement plan benefits or other postemployment benefits. If the future costs of the changes exceed one-half of 1 percent of the future annual costs, as defined in paragraph (2) of subdivision (a), of the existing benefits for the legislative body, an actuary shall be present to provide information as needed at the public meeting at which the adoption of a benefit change shall be considered. The adoption of any benefit to which this section applies shall not be placed on a consent calendar.

(B) The requirements of this paragraph do not apply to:

(i) An annual increase in a premium that does not exceed 3 percent under a contract of insurance.

(ii) A change in postemployment benefits, other than pension benefits, mandated by the state or federal government or made by an insurance carrier in connection with the renewal of a contract of insurance.

(2) With regard to the Legislature, the future costs as determined by the actuary shall be made public at the policy and fiscal committee hearings to consider the adoption of any changes in public retirement plan benefits or other postemployment benefits. The adoption of any benefit to which this section applies shall not be placed on a consent calendar.

(d) Upon the adoption of any benefit change to which this section applies, the person with the responsibilities of a chief executive officer in an entity providing the benefit, however that person is denominated, shall acknowledge in writing that he or she understands the current and future cost of the benefit as determined by the actuary. For the adoption of benefit changes by the state, this person shall be the Director of Human Resources.

(e) The requirements of this section do not apply to a school district or a county office of education, which shall instead comply with requirements regarding public notice of, and future cost determination for, benefit changes that have been enacted to regulate these entities. These requirements include, but are not limited to, those enacted by Chapter 1213 of the Statutes of 1991 and by Chapter 52 of the Statutes of 2004.

DRAFT CHARTER

PENSION OVERSIGHT COMMITTEE

COMMENTS ON "ADDITIONAL IMPACT ANALYSIS"

MAY 21, 2014

Annual financial impact for 30 years and risks to the City and its General Fund.

This type of disclosure and the four that follow should be available to anyone (CEO, Council Members, and Voters) that will be recommending and/or deciding to increase a pension or other defined retirement benefit. Pensions are commitments (liabilities) that can last 60 years and longer during an employee's lifetime and beyond. It is important that the long-term actuarial costs and liabilities to the City are understood.

It is also important that the risk and potential impact of a future negative change in an actuarial assumption or assumptions (retroactive application, earnings / discount rate, life expectancy, length of employment, age at retirement, compensation growth rate, inflation rate) be disclosed in a general statement by the Actuary. A future negative change in assumptions (particularly the discount rate or retroactive application) can be very costly to the City because (1) the City's accrued pension liability is always large due to most employees having a long retirement benefit (can retire at age 50 or 55) at a high percentage of their highest annual pay (up to 75% or 90%), (2) retired employees are not responsible for sharing in the payment of unfunded liabilities, and (3) there is generally no "cushion" or "reserve" available unless pensions happen to be over funded.

Any changes in unfunded liability and the reasons therefor.

This is a key disclosure because the unfunded portion of a pension liability receives no allocation of CalPERS' investment earnings. Therefore, a separate "unfunded contribution" must be paid by the City into the City's pension funds held by CalPERS just to cover the lost allocation of earnings and prevent the unfunded portion from growing. If CalPERS decides that the unfunded liability must be amortized / paid off by the City (as it appears CalPERS has now decided) then the increased annual "unfunded contributions" can significantly impact the City's General Fund and its ability to maintain and operate the City.

Any financial impact from retroactive application of benefits.

This is a key disclosure because the California legislature could decide in the future to eliminate the provision in PEPRA that prohibits increased retirement benefits being retroactively applied to "prior service". The retroactive application of an increase in pension benefits automatically and instantly results in an unfunded liability because the additional benefits were not funded during such "prior service" by either the City or employee. This was part of the cause of the City's $228 million unfunded pension liability created between 1999 and 2010.

Impact of future retirement fund earnings calculated at one percentage point above and below the actuarially projected earnings / discount rate.

This is an important disclosure of risk because it shows what would happen if CalPERS fails to achieve their "earnings / discount rate" assumption and future earnings fell below their actuarial projection by one full percentage point (say from 7.5% to 6.5%). The lowering of the "earnings / discount rate" by CalPERS was a major cause of the $228 million unfunded pension liability. This disclosure would also show what would happen if CalPERS' earnings are better than projected (say from 7.5% to 8.5%). Comparing the two possibilities would show the impact of a two percentage point change in the projection of future earnings.

Present value of annual retirement benefits for a representative sample of employee positions.

This is a key disclosure because it shows the present value of the retirement benefits that selected employee positions will receive. This discloses the retirement benefits of those employee positions for fairness, sustainability and reasonableness.

Reconciling Section 7507 with Charter Section 600 – "post-employment benefits".

Should the City Council approve the Pension Oversight Committee's recommendation and include "Section 601" in the Charter, then the term "Employee Retirement Benefits" should be added to Section 600 between the words "liable" and "without".

To be consistent with Government Code Section 7507, it may be preferable to change the phrase "post-retirement" in Section 600 to "post-employment".