A Tradition of Stewardship
A Commitment to Service

NAPA COUNTY GRAND JURY

2012-2013

JUNE 24, 2013

FINAL REPORT

A REVIEW OF NAPA COUNTY PUBLIC EMPLOYEE RETIREMENT BENEFITS

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NAPA COUNTY GRAND JURY

P.O. BOX 5397

NAPA, CALIFORNIA 94581

A Tradition of Stewardship
A Commitment to Service

June 24, 2013

The Honorable Mark S. Boessenecker
Supervising Judge
Superior Court of the State of California
County of Napa
825 Brown Street
Napa, California 94559

Re: 2012-2013 Grand Jury Final Report: Napa County Juvenile Hall.

Dear Judge Boessenecker,

Pursuant of Section 933 (a) of the California Penal Code, the 2012-2013 Napa County Grand Jury submits its final report on the Napa County Juvenile Hall.

Our investigation of this subject was conducted in a manner consistent with the California Penal Code, this Court's Charge, and the historic role of the Grand Jury, to pursue the interests of the residents of Napa County.

This is the seventh in a series of final reports we will be issuing during our term. I would like to acknowledge the dedication of the Grand Jurors, which our report reflects.

Respectfully submitted,

Victor J. Connell
Foreperson
2012-2013 Napa County Grand Jury

NAPA COUNTY GRAND JURY

P.O. BOX 5397
NAPA, CALIFORNIA 94581

June 24, 2013

To the Residents of Napa County:

Our seventh Grand Jury Final Report is on the Napa County Public Employee Pension Benefits.

The Napa County Office of County Counsel has reviewed this final report. The Napa County Superior Court Presiding Judge, pursuant to California Penal Code Section 933(a), has found that this report complies with California Penal code Part 2 Title 4.

Copies of this report are available for review in the Napa City-County Library and online at www.napa.courts.ca.gov (follow the link to the Grand Jury).

We hope you find this report informative. It is an honor and privilege to serve you during our 2012-2013 Grand Jury term.

Respectfully submitted,

The 2012-2013 Napa County Grand Jury

A REVIEW OF NAPA COUNTY PUBLIC EMPLOYEE RETIREMENT BENEFITS

Keep Calm and Carry On...

SUMMARY

In 1999, during a booming dot-com stock market, the California Legislature enacted SB400, which enabled generous and unprecedented retroactive pension enhancements to active public employees. Lawmakers and supporters called it “sharing the wealth”. The Wall Street Journal called it:

> The largest issuance of non-voter-approved debt in the state’s history.

The timing could not have been worse. As the stock market began a precipitous decline, the value of pension funds on deposit declined 23 percent from a high of $172 billion in early 2000 to $133.8 billion in 2002. The California pension crisis was locked and loaded.

The 2007-2008 Napa County Grand Jury investigated the status of County employee retirement benefits and expressed serious concerns about the trajectory of funding for retirement obligations. That Grand Jury joined think tanks and other citizen grand juries in calling for reform of the California Public Employees Retirement System (CalPERS), the State’s manager of most public employee pensions and other post-employment benefits (OPEB), chiefly retiree health care.

The situation deteriorated further throughout the most recent recession as CalPERS’ portfolio return on investment (ROI) continued to plummet. In light of the protracted recession and slow recovery, the 2012-2013 Napa County Grand Jury decided to investigate and report on the present condition of the Napa County Employee Retirement Benefits.

As detailed below, the 2012-2013 Grand Jury finds that Napa County is in much better condition than the great majority of California counties. The Grand Jury recognizes the prudent decisions that the Napa County Board of Supervisors has made in the past and recommends that the County continue to opportunistically implement policy to improve the funding of the Napa County Employee Retirement Benefits System.

BACKGROUND

California Public Employees' Retirement System

Napa County contracts with CalPERS to provide retirement benefits for approximately 1,330 County employees and retirees. Created in 1932, CalPERS is the largest U.S. public-sector pension system, with over $254 billion under management, providing benefits to 1.6 million public employees on behalf of over 3,000 public employers. By State law, CalPERS is an independent agency with sole authority to administer the retirement funds of contracting entities, to collect both employee and employer annual required contributions (ARC), to manage the investment of funds, and to conduct an annual actuarial valuation of each agency's funds in order to determine the benefit plan funded level:

$$\text{Benefit Plan Funded Level} = \frac{\text{total value of fund assets}}{\text{total accrued fund obligation}}$$

In addition, CalPERS has sole authority to determine the assumptions used to conduct these valuations, including projected ROI and lifespan estimates.

Vallejo’s 2009 bankruptcy filing was viewed as a clarion call for reforming funding levels. At the bottom of the recession in June 2009, Napa County’s retirement benefits funded level was just 60 percent, well below the 80 percent threshold considered by experts to be necessary for sustainable solvency.

The burgeoning economic recovery of late 2009 caused CalPERS' ROI to strengthen and thus its funded levels increased. In late 2012, thirteen years after SB400, the California Legislature enacted AB340, the Public Employee Pension Reform Act of 2013 (PEPRA). While falling short of fundamentally reforming public pensions, PEPRA mandated pension modifications that are expected to improve future funded levels. Napa County’s funds rebounded faster than many California agencies. Before statewide reform, the County negotiated union agreements that reduced pension formula and increased employee cost-sharing. By June 2011, the latest data available, the County's retirement benefits funded level had improved to 73.8 percent. In addition, the County's prudent action to voluntarily pre-fund OPEB obligations on an aggressive schedule put the County on track to fully pay off this unfunded liability.

Funded levels are on a more sustainable path, but significant risk remains. CalPERS warned in March that the probability of its funds not falling below a 50 percent funding level, from which it would be difficult to recover, is only 50/50. Moreover, there are lessons to be learned from the last fifteen years' cycle of boom, bust, and now partial-recovery of California's public employee retirement benefit funds.

The 2012-13 Napa County Grand Jury investigation focused on identifying these “lessons”. Because Napa County has by law only limited authority over retirement benefits, special attention was given to identifying the actions of all California agencies that either aided the sustainability of funds, or contributed to the high-risk situation of virtually all funds just four years ago. Finally, despite the significant recovery, the total unfunded liability of $173,965,000, or $1,275 for every County resident, is one of the largest County liabilities and merits close citizen scrutiny.

Unfunded	**Date**	**Amount**	**Census Napa Residents**	**Liability per Resident**
OPEB Liability	6/30/2011	$ 34,065,000	136,484	$ 250
Pension Liability	6/30/2011	$139,900,000	136,484	$1,025
Totals		$173,965,000		$1,275

Napa County provides employees a defined benefit pension. This type of plan, which predominates in the public sector, specifies pension income, and allows the annual required contribution (ARC) to CalPERS to vary, primarily based on fund ROI. Defined contribution pension plans, rarely utilized in the public sector, are the well known 401 (k)-type of plans that allow pension income to vary while contributions are specified.

On an annual basis, CalPERS calculates the ARC that each agency must pay to meet pension plan objectives. Napa County has typically contributed roughly 75 percent of the ARC and its employees contributed the remaining 25 percent.

There are over 80 possible pension formulas established by California law that can be used by local agencies. Napa County has negotiated the following formulas for its safety employees (police and fire) and miscellaneous employees (all others):

Tier	Safety	Miscellaneous
1	2%@50	2%@60
1-Enhanced	N/A	2.5%@55
2	3%@50	2%@60
3	3%@55	2%@62
4	2.7%@57	N/A

Pension formulas express the percent of “final salary” earned each year of service and the age of full retirement, e.g., “Tier 1 Miscellaneous Formula of 2%@60”, means 2 percent of “final salary” is earned each year of service, and 60 is the “full retirement age”.

Other Napa County policies:

- Retiring before “full retirement age” reduces the pension.
- All employees must have 5 years of service to qualify for benefits.
- “Final salary” is either the highest single year’s, or the average of the highest three consecutive year’s regular and recurring salary, per negotiated Memorandum of Understanding (MOU).

Retirement benefits are a significant line item in the County budget. In FY2012-2013 the County portion of total employee pension costs is expected to be ~ $19 million, about 19.9 percent of payroll and 4 percent of the overall County budget. This compares to the average share of state and local budgets devoting 6 percent to pensions, as reported by CalPERS.

METHODOLOGY

Interviews Conducted

- Napa County Chief Executive Officer
- Napa County Human Resource Director
- Napa County Financial Staff, Office of the County Executive Officer
- Napa County Board of Supervisor
- Napa Association of Public Employees, SEIU Local 1021
- Actuarial Consultant for Napa County

Documents Reviewed

- Recent Annual Actuarial Reports for all Retirement Benefit Plans of Napa County Employees
- 2010 Governor’s Report: Needed Public Employee Pension Reforms
- Text of PEPRA
- 2011 Little Hoover Commission Report: Public Pensions for Retirement Security

- Publications of grand juries, associations, commissions, universities and newspapers regarding the California Public Employee Pension Crisis (see Bibliography)
- Federal and local government reports on hybrid pension plans (see Bibliography)

DISCUSSION

Napa County leadership and staff have generally demonstrated a fiscally responsible and conservative approach to employee retirement benefit management, especially in the last eight years. For example, unlike other California public entities where compensation policies allowed certain public employees to collect more annual retirement income than they earned as salary, Napa County chose practices that prevented such abuses. The County's pension programs never allowed the "spiking" of final salaries with bonuses, unused vacation time, overtime pay and other non-regular compensation amounts.

In 2008, once the State Legislature approved the ability of local entities to prefund OPEB liabilities, the County was among the first in California to adopt this policy. At that time, the County adopted an aggressive 14-year pay-off schedule of the unfunded OPEB liability, although the amortization period was later increased to 20 years as part of the County's recession-induced contingency planning. The current schedule is still aggressive compared to other entities and is expected to enable OPEB funding to reach a 50 percent funded level before the end of 2013.

In FY2010-2011, a strong history of mutual respect and trust between the County and its employee bargaining units enabled agreement on lower pension formulas overall and pushed back the age of full retirement for some employee categories. County leadership and staff took these uncommonly assertive steps to improve the affordability and sustainability of retirement benefit programs more than a year before action on pension reform by the California State Legislature. These changes are projected to save the County over $12 million within a decade after implementation.

The Grand Jury found that the County's prudent decision-making regarding retirement benefits has continued during the recovery of fund levels. In recent months the County Board of Supervisors abandoned an OPEB plan benefit that previously allowed County department heads and some elected officials to earn lifetime healthcare benefits. In addition, in April 2013, the County was one of the few in the State to pay the full CalPERS 1.1 percent ARC increase for 2013-2014 rather than phase it in over two years, which will result in further cost savings.

There is no doubt that Napa County's strong and stable economic climate has facilitated the ability to be proactive in managing all of its assets. The County is fortunate in that it is a relatively young public entity measured by the high number of active employees supporting the retirement income of retired employees, and has a high-valued land base

and well established agricultural and tourist commerce supporting tax revenues. Most importantly, the Napa County Board of Supervisors has a history of acting fiscally responsible in managing County assets.
Not every decision was so prudent, however. Ultimately, in FY2004-2005 the County acquiesced to State and employee pressure to provide the retroactive benefit enhancements of SB400, thus participating in what was termed the benefit “arms race” by California’s independent watchdog organization, the Little Hoover Commission. These enhanced benefits had already been adopted by most peer agencies in the State, and anticipating the need to match the benefits, the County had already established a side fund to mitigate looming increased costs. Additionally, in its negotiations with the unions, the County gained agreement to a trade off requiring employees to share any future changes in ARC, an action of great foresight. Even so, the impact of the new MOUs was dramatic and rapid. When combined with the nearly simultaneous downturn in the financial markets that saw CalPERS returns swing from a positive 10.5 percent return in FY2002-2003 to a negative 7.2 percent return in FY2003-2004, the result was a doubling of the County’s ARC payment for miscellaneous employees, from 6.9 percent of payroll to 13.9 percent of payroll. These significant investment losses, combined with enhanced unfunded retiree benefits, caused annual pension costs for the County to increase from $7.5 million in FY2004-2005 to $11.2 million in FY2005-06.

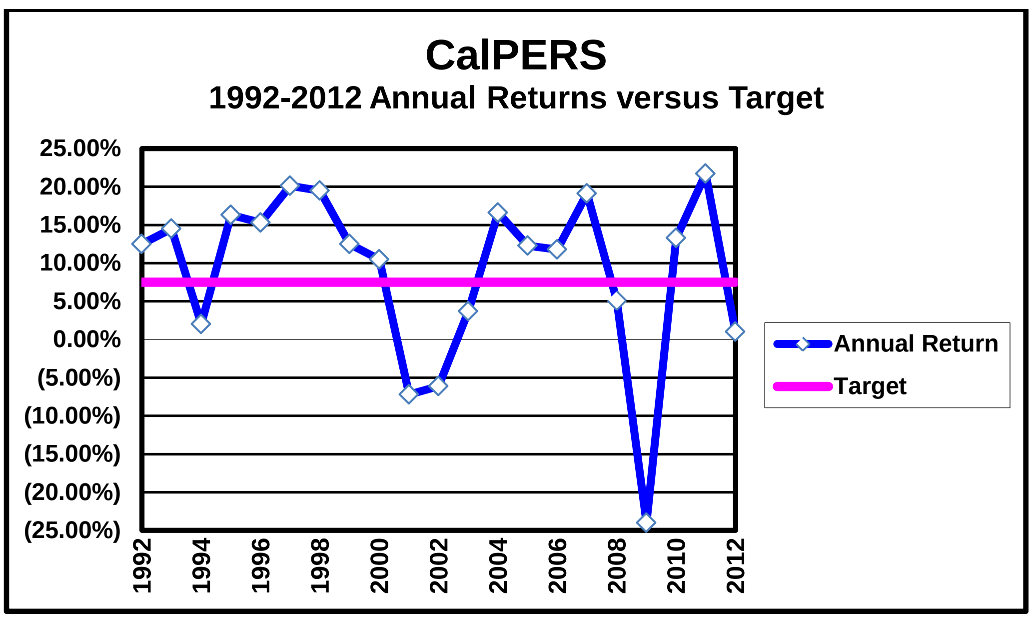
The Grand Jury found that the sustainability of OPEB programs is currently more of a concern to County officials than that of its pension programs. At the heart of County concerns are the steep increases in healthcare premiums, which have risen faster than the cost of living adjustments that affect pension funds. The Government Financial Officer’s Association (GFOA) recently published a report that detailed the challenging task of managing employee healthcare costs. In the report, the GFOA made several recommendations to public entities, noting the effectiveness of high-deductible and/or higher co-pay health insurance plans in reducing healthcare costs.

The challenge of local agency retirement benefit management: between a rock and a hard place

In many ways, the odds are stacked against local agencies with respect to their ability to manage retirement fund assets. There are two factors that impact the sustainability and affordability of pension and OPEB plans. First is the magnitude and certainty of benefits provided and the age at which employees can access the benefits. The Grand Jury found that these are somewhat controllable by public employers, although labor market competitive pressures are brought to bear such as existed after SB400. The State’s overriding authority over public pensions and the negotiating power of public employee unions often encourage negative local actions and/or restrain positive local action. CalPERS estimates that 15 percent of the State’s unfunded retirement benefit liability is the result of retroactive benefit enhancements enabled by the State and implemented by state and local agencies.

Secondly, and of even greater consequence, is the ROI of invested benefit funds, which is controlled by financial market conditions and CalPERS' investment choices. CalPERS' independent board of directors has unfettered authority to set ROI expectations that are used to value the funds and set ARCs. Because of compounding interest, CalPERS' benefit plans are structured such that 70 percent of planned future retirement dollars are to be generated from investment returns. Consequently, the County's prudent actions to improve funding levels, while exemplary, were eclipsed by the poor performance of CalPERS' investment portfolio. CalPERS' disappointing returns were further exacerbated by the impact of the Agency's overly optimistic ROI planning values. Over a five-year period, while the County increased its ARC payments by more than 20 percent, the funded level of the County's miscellaneous pension plan actually declined by 27 percent. CalPERS' ROI planning has been a major contributor to underfunding. It's easy to understand why: unrealistically high ROI projections by CalPERS results in lower required fund contributions, which reduces funded levels. CalPERS currently projects a 7.5 percent average annual return, a level which has been roundly criticized since the average ROI over the last ten years was 6.1 and for FY2011-2012 was just 1.0 percent.

CalPERS historical annual return vs. target



Increasingly unfunded levels of retirement benefit obligations will have a serious impact on the ability of public entities to continue to fund the public services demanded by their constituents. This is especially true for entities that do not have a growing tax base and/or do not have the ability to raise new tax revenues. The experience of the four California cities that have filed bankruptcy petitions, Vallejo, Mammoth Lakes, San Bernardino and Stockton supports this conclusion. Each of these cities experienced significant public sector layoffs as their financial condition worsened.

By 2015, several of the State's largest cities estimate that as much as 33 percent of their total operating budget will be consumed to make the annual required contributions to

CalPERS. Even Napa County, with a significant and stable economic base, no incidence of abusive pension practices, and no risk of bankruptcy has had to confront tough choices as the shortfall in funding of retirement obligations over the last decade has created larger and larger ARC payments to CalPERS.
Virtually all local agencies in California can expect their ARC's to continue to rise as a result of an announced major overhaul of CalPERS' investment policies, including planned reductions to CalPERS' discount rate (projected ROI) and changes to the actuarial methodology of smoothing (or averaging) investment gains and losses. While designed to level out big swings in ARC which are difficult for local agencies to accommodate, the current smoothing methodology extended the time to full funding of plans substantially, at one point to an untenable 30+ years.

These CalPERS methodology changes, which may also include a discount rate reduction, will be phased in over 5 years beginning in FY2015-2016, and could increase the ARCs of some public entities by as much as 50 percent.

The County's foresight in negotiating a 50/50 sharing of ARC changes with employees was indeed prescient. When these ARC increases are implemented, the County will not face the issues that may well cause other California entities to raise additional taxes, divert dollars from contingency funds, or reduce public services.

Doctrine of "vested rights"

The Grand Jury found that the application of the legal doctrine of an employee's individual "vested right" to promised retirement benefits, consistently upheld by the California courts, significantly limits the ability of local agencies to manage public pension and OPEB obligations. State courts have extended the doctrine to benefits that are not yet earned, thereby preventing the reduction or elimination of benefits even when the employer/agency is in dire financial condition.

Each of the four California cities that has sought federal bankruptcy protection since 2009 cited the inability to impair (reduce) retirement benefits as a major contributing factor in their financial collapse. Vallejo continued to make pension contributions throughout its 3 1/2 year bankruptcy while all other debts were subordinated. Ultimately, when confronted with the possibility that the federal bankruptcy court might impair pension obligations, Vallejo's unions accepted a $100 million OPEB reduction.

Defined contribution and hybrid pension plans may not be the answer

Employee retirement benefits are guaranteed, thus defined benefit pension plans place the entire risk of investment losses on employers and by extension on taxpayers. It is not surprising that the pension crisis drove increased public interest in alternatives to defined benefit pension plans. Even Governor Brown advocated a hybrid pension approach when he released his groundbreaking recommendations for reform of public pensions in 2011. A hybrid pension would combine a smaller defined benefit plan with a 401(k)-style defined contribution plan designed to make up the difference in planned total retirement income. Under continued pressure from unions, the State Legislature did not include a hybrid pension mandate in the final AB340 legislation. However, some entities, including the cities of San Diego and San Jose and the County of Orange have taken independent steps to hybridize their plan. In some cases, the entities have sought and achieved voter approval of these measures (San Jose and San Diego). Each of these entities has encountered union opposition and/or IRS regulation impediments to the implementation of the reforms. In addition, the Public Employees' Relations Board has opposed the ballot-approved hybrid plans and the matter is likely to go to court.

Defined contribution plans may not be a good choice for public pensions. In addition to the risk to retirement income security for the employee, numerous studies have identified the high cost of replacing an existing defined benefit plan with a defined contribution plan (for example, by law CalPERS would compel the immediate payoff of any unfunded liability) as well the increased ongoing cost of administering a defined contribution plan.

A study conducted in 2008 by the National Institute on Retirement Security concluded that the cost of providing retirement income is 46 percent lower in a defined benefit plan than in a defined contribution plan. Several factors influenced the finding:

- The tendency for individuals in defined contribution plans to shift more assets to lower yielding investments as they age

- The inability of individuals to pool mortality risks

- Differences in fees and average rate of return for individually managed accounts in defined contribution plans compared to professionally managed assets in defined benefit plans

The State (finally) acts to (partially) reform public pensions

The State of California, despite considerable citizen interest in fundamental reform of public pensions, has consistently retained legal authority for the Legislature and CalPERS to administer public employee benefit issues. In providing such little flexibility to local entities to manage these benefits, the State is substantially responsible for the pension crises of local entities over the last fifteen years.

After a failed attempt at pension reform in 2009 and subsequent protracted, partisan battles in the Legislature, a watered-down version of AB340 was enacted in late 2012. PEPRA falls short of the fundamental reform that could lower the risk of a repeat crisis, but has provided some needed support to local entities. Beginning in 2013, PEPRA mandates new tiers of lower benefits and increased employee pension cost sharing. The Act also limits pensionable compensation and eliminates spiking of final compensation with non-regular compensation items. PEPRA also prohibits a previously common practice of entities taking a break or "holiday" from making annual contributions.

Because the Act did not allow the alteration of future unaccrued retirement benefits for current employees, the most significant PEPRA cost savings will be realized only as new employees are hired in the future. Napa County has implemented most of the changes in PEPRA, except for the provision that requires employees to pay at least one-half of the normal cost of their benefits, due to an existing MOU that expires in 2014. This cost sharing provision of PEPRA is the only opportunity for near term savings for the County, and the Grand Jury recommends that the County implement this provision of PEPRA at the negotiation of a new MOU next year.

A moving target?

On a cautionary note, there are several legal challenges to provisions of PEPRA working their way through State courts. If any of these challenges are successful, the subject provisions, or even the entire body of PEPRA legislation may be overturned. If this occurs, all of the State support for pension reform in local entities could evaporate. It is thus important that the County consider the Grand Jury's Recommendations, even those that PEPRA currently shows promise to make unnecessary. Addendum A details the provisions of PEPRA and the status of the County's implementation of the Act.

There are some other developments that could improve the ability of the County to manage its retirement benefit assets. The doctrine of public employee individual vested rights to retirement benefits could change as a result of bankruptcy proceedings involving Vallejo and Stockton. The Federal Judge involved in the Vallejo bankruptcy, in support of that city's move to impair its OPEB obligations, declared:

> While a state cannot make a law impairing the obligation of contract, Congress can do so.

Furthermore, the Federal Judge in the Stockton bankruptcy hinted that he might rule the city's indebtedness to CalPERS does not merit preferential treatment as compared to other indebtedness. Such a final ruling would substantially erode the doctrine of an employee's individual vested right and permit entities to correct their pension enhancement action**s** of the past.

CONCLUSION

Media reports on public employee retirement benefits have admittedly been colored by political considerations, but there are also broad areas of agreement. In 2011, the Little Hoover Commission summarized its view of the pension crisis in an often-quoted publication:

> California’s pension plans are dangerously underfunded, the result of overly generous benefit promises, wishful thinking and an unwillingness to plan prudently.

Likewise, Leigh Snell, the Federal Relations Director for the National Council on Teacher Retirement, in an article that cautioned against over dramatization of pension issues, noted:

> If plan participants demand retroactive benefits that have not been adequately funded, or if employers fail to make their annual required contributions as agreed, then it is virtually inevitable that the plan’s fiscal stability will become unbalanced over time.

The Grand Jury found that fixing public retirement benefits should be a non-partisan matter, since it is in every citizen’s interest that public employees earn a retirement income adequate for their future needs and to which they sufficiently contribute while employed. There is a fairness issue as well. Many Napa County employees’ retirement income security is totally dependent on the benefits earned from the County since they are not eligible to participate in Social Security. The Grand Jury found that the County has been collegial in proactively working with its employee bargaining units, CalPERS and citizens to make positive changes to its retirement benefit programs.

For the last eight years, the County has made a series of prudent decisions about its retirement benefits that have led to an increasingly funded, affordable and more stable retirement benefit status. Public officials have a responsibility to learn from past mistakes and be vigilant in the management of all County assets. In Napa County, there is strong evidence that this has been the case, and as it pertains to public employee retirement benefits, the County has shown very good stewardship.

FINDINGS

F1. Napa County never allowed the “spiking” of final salaries for pension benefit calculation, with one-time bonuses, unused vacation time and other extraordinary compensation items.

F2. In FY2004-2005, Napa County, like virtually all California entities, adopted retroactive enhanced pension formulas enabled by SB400. These benefit enhancements contributed to reduced funding levels.

F3. Subsequently, Napa County took assertive steps, ahead of the California State Legislature action on public pension reform, to reduce future County pension and OPEB liabilities.

F4. In FY2010-2011 the County adopted lower pension formulas for all employee categories.

F5. Napa County's strong and growing local economy has helped to maintain the affordability and sustainability of pension and OPEB benefit plans despite increasing ARCs.

F6. The most significant contributor to the growing levels of unfunded pension and OPEB liabilities is CalPERS' ROI, a factor that is not controlled by Napa County.

F7. Under the doctrine of "vested rights", pension and OPEB benefit formula reductions can only be applied to new employees; thus, such changes will do very little to reduce the County's unfunded liabilities in the next 10-15 years.

F8. Statutes and institutionalized policies have impeded progress toward reducing unfunded liabilities of retiree benefit plans. As a consequence, a single incident of imprudent management of retirement benefits, or unexpectedly negative investment returns, can have a long term negative impact on funding status of such liabilities.

F9. The concept of a hybrid pension plan has become more popular with taxpayers and has been approved by voters in some California entities. However, such plans face legal and logistical hurdles and may not be the most equitable and cost-effective method of providing retirement income security to public employees.

F10. Napa County has experienced steep increases in healthcare costs for both active and retired employees, which has contributed to the difficulty in managing OPEB funding.

F11. In late 2012, the State Legislature enacted the California Public Employee Pension Reform Act of 2013 (PEPRA), which has enabled CalPERS-contracting entities to reduce future post-retirement benefit obligations. Napa County is well along the path to the full implementation of PEPRA.

F12. PEPRA, combined with recent proposed changes to CalPERS's actuarial methodology and the potentially precedent-setting legal challenges to public employees' "vested right" to retirement benefits, show promise to provide improved capability of public entities to manage their retirement benefit obligations while still retaining qualified employees.

RECOMMENDATIONS

R1. Implement all PEPRA provisions as soon as practicable, but no later than at the time of adoption of the next memorandum of understanding (MOU) with the employee bargaining units.

R2. Maintain a maximum 20-year amortization of the unfunded OPEB liability in addition to funding all current obligations on a pay-as-you-go basis. Reduce the amortization period if an opportunistic funding mechanism develops.

R3. Develop plans to control future health care costs including the concepts advocated by the Government Finance Officers Association (GFOA) of accessing increased-deductible or higher co-pay insurance plans.

R4. Implement a side-fund to offset the risk of overly optimistic discount rate assumptions by CalPERS, if a budget surplus or another opportunistic funding source becomes available.

R5. Develop a plan to phase in the ARC changes that will result from recently announced CalPERS actuarial methodology and discount rate changes, as quickly as financially feasible.

R6. If favorable rulings result from federal bankruptcy proceedings concerning California jurisdictions, investigate freezing earned pension benefits of active employees who were beneficiaries of the SB400 retroactive formula enrichments and reset to the to the lower formulas in effect when the employees joined the County.

REQUEST FOR RESPONSES

Pursuant to Penal code section 933.05, the grand jury requests responses to all recommendations:

From the following governing body:

Napa County Board of Supervisors: R1-6.

GLOSSARY OF TERMS AND ACRONYMS

Annual Required Contribution (ARC): Annual required contribution is the amount the employer is required to contribute to a defined benefit pension fund annually, based on an actuarial formula, to fund current and future retirement benefits and liabilities. It is the amount needed to payout the benefits of future retirees.

CalPERS: California Public Employees Retirement System.

Discount Rate: The time value of money. On a yearly basis Pension plans utilize a discount rate to determine how much money needs to be invested in order to meet pension obligations in the future.

Defined Benefit: A promised specified monthly benefit upon retirement. Assets are held in a defined benefit plan (CalPERS) that assumes all investment risks.

Defined Contribution: Contributions are made by the employer to an individual employees investment account such as a 401k. All investment risks are those of the employee.

Hybrid Plan: Pension plan that combines components of both a defined benefit plan and a defined contribution plan.

MOU: Memorandum of understanding between employee bargaining units and employer**.**

OPEB: Other Post-Employment Benefits, mainly health care benefits.

PEPRA: Public Employees' Pension Reform Act (also referred to as AB340).

ROI: Return on investment.

Smoothing: Accounting and actuarial practice of spreading (averaging) investment gains and losses over a defined period of time. The purpose of smoothing is to minimize short term, year-to-year contribution rate fluctuations which can result from market swings. The smoothed asset value is the actuarial value of assets.

Unfunded Liabilities: Pension obligation and promises made for future benefits that are not matched by current assets.

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APPENDIX A

AB 340

The California Public Employees' Pension Reform Act of 2013 - PEPRA

This bill went into effect on January 1, 2013 and amends various provisions of the Public Employee's Retirement Law, Teacher's Retirement Law and County Employee's Retirement Law of 1937.
A new employee is an employee who first becomes a member of any public retirement system on or after January 1, 2013.

PROVISIONS	STATUS OF NAPA COUNTY IMPLEMENTATION
Reduces Benefits Formulas and Increases Retirement Ages for New Employees Formula for non-safety miscellaneous members will be 2 percent at age 62 percent with a maximum of 2.5 percent at 67, early retirement possible 52 at 1 percent. Three formula options for safety members: 2 percent at 57, 2.5 percent at 57 and 2.7 percent at 57. CalSTRS has a new formula of 2 percent at 62 with a maximum of 2.4 percent at 65.	New Miscellaneous (non-safety) employees/members hired on or after January 1, 2013, have a new defined benefit formula of 2 percent at age 62 with an early retirement age 52 and maximum benefit of 2.5 percent at age 67. New safety employees/members hired on or after January 1, 2013 have a new defined benefit formula with a normal retirement of 2percent at age 50 and a maximum retirement formula of 2.7 percent at age 57.
Caps on Pensionable Compensation for New Employees For employees subject to Social Security, final compensation cannot exceed 100 percent currently at $113,700. * Employees who **do not** participate in Social Security, final compensation cannot exceed 120 percent of that amount, currently at $136,400. * This cap would adjust annually. * **based on the 2013 Social Security Contribution & Benefit and Base**	Income Caps: Caps the annual salary that counts towards final compensation for all new employees, excluding judges, at $136,440. The compensation cap would adjust annually based on the CPI for All Urban Consumers.

Eliminate Replacement Benefit Plans for New Employees Would prohibit public employers from offering a plan of replacement benefits for new members. Final compensation for calculating retirement benefits will be based upon the highest average annual pensionable compensation earned by a member during a period of at least 36 consecutive months for all new employees/members hired on or after January 1, 2013.	Miscellaneous County employees already have this definition of final compensation; Safety employees hired before January 1, 2013, use the highest 12 months of compensation for retirement calculations.
Employee Cost Sharing for Current and New Employees Requires new members to pay at least 50 percent of normal cost, not to be paid by employer on employee's behalf Employee contributions for new members can be more that 50 percent if the increase has been agreed through collective bargaining. **Revisions to Government Code section 20516 will provide greater flexibility for employers and unions to negotiate cost-sharing of the employer's contribution for both new and current members.**	New Napa county Miscellaneous employees/members (non-safety) half the total current normal cost is 6.25 percent of salary and for new safety employees/members the rate is 11.5 percent. Employees represented by the Public Service Employees/SEIU and the Deputy Sheriffs' Association both have current labor agreements in place and will contribute the same as the current employee/members until the MOU expires or is amended at which point they will pay half the total normal cost. New management and confidential employees/members hired on or after January 1, 2013 contribute either (currently) 6.25 percent for non-safety or 11.5 percent for safety employees/members. **Note:** the Deputy Sheriffs' Association MOU expires September 30, 2013 and the SEIU MOU expires on June 30, 2014.

Limitations on Post Retirement Employment for Current and New Employees Limits all employees who retire from public service from working more than 960 hours or 180 days (non-safety retiree) per year for any public employer in the same retirement system from which the employee receives benefits.	Since January 1, 2013, Napa County has not hired a retired annuitant with less than an 180-day break in service since retirement. Retirees are hired based upon special skills needed by the County and are limited to working 960 hours in a fiscal year.
Three-Year Averaging for Final Compensation for New Employees Final compensation for calculating the pension benefit is determined by averaging highest annual compensation over a consecutive 36-month period, or 3 school years. **Napa County currently has a minority of local agencies using a 3-year average, most use highest compensation over a 12-month period.**	Miscellaneous County employees already had this definition of final compensation; safety employees hired before January 1, 2013, use the highest 12 months of compensation for retirement calculations.
Ban on "Air Time" Purchases for Current and New Employees Prohibits public retirement system purchase of non-qualified service credits, or air time, after January 1, 2013.	CalPERS has not accepted new applications for non-qualified service credit since December 31, 2012.
No Retroactive Benefit Increases for Current and New Employees Only service performed after the date the formula or benefit enhancement becomes operative may be credited at the enhanced level.	Napa County meets the new requirements of PEPRA.
No Pension Holidays for Current and New Employees A public employer's contribution plus the employee's contribution must equal the full normal cost for the plan year except under very limited circumstances	Effective January 1, 2013, Napa County meets the new requirements of PEPRA.
Forfeit Pension Benefits Upon Felony Conviction for Current and New Employees Requires public officials and employees to forfeit pension benefits if they are convicted of a felony related to the performance of official duties. Only pension benefits earned after the earliest of the commission of the felony are subject to forfeiture, not those earned prior to the commission of the felony.	Napa County has not had any officials or employees convicted of a felony. Should such a situation exist in the future, the retiree will forfeit any post-retirement benefits earned during County service after the commission of a felony.