To: **MCCMC Legislative Committee**

From: **Larry Chu**
Mayor, City of Larkspur
Chair, Ad-Hoc Committee on Pension & OPEB Reform

Date: **March 4, 2011**

RE: **Issues with Pension & OPEB Committee**

At the MCCMC meeting of the Legislative Committee on February 28th, a number of concerns and issues were raised about the ad-hoc committee ("Committee") to study reforms on pensions and other post-employment benefits.

I will provide a response and clarification on each as I know them.

<u>Committee Objectives</u>:

These are outlined in my October 25, 2010 to the Mayors Select Committee (MSC). There has been no deviation from the Committee's scope of work. Because the best regular meeting date was the fourth Monday of the month, we are running one month behind my original projected schedule since the fourth Monday has typically been after the MCCMC's regular meeting date.

It has been made explicitly clear on several occasions what this Committee will and will not do:

- It will approach and frame the problem from a context of municipal finances and how the uncertainty of the costs and risks associated with post-employment benefits impacts programs, services, budgeting, and cash flow.

- It will create a comprehensive list of solutions with qualitative impacts to other stakeholders, the dependencies in which the solutions become feasible, and the time frame in which the benefit of implementation can be realized.

- It will not debate which discount rate is appropriate for the determination of the unfunded liability.

- It will not attempt to forecast future economic conditions.

By identifying a series of cause-and-effect relationships through a set of decisions, you can analyze the future impact of current decisions. If you don't like the outcome, you evaluate other alternatives.

<u>MCCMC Members Are Acting in Concert</u>:

The committee was assembled as a means for member cities/towns to collaborate and to share ideas and data. To avoid the perception of collusion, the final report will not make any recommendations. It will create a full range of solutions and impacts for making budgeting decisions. Each city/town will decide on what to implement based on its own financial circumstances and policies.

In principle, it would seem contradictory for labor groups to have collective bargaining while the employers are not able to have public discussions in a fiduciary capacity to solve a common problem.

Too Much Media Attention:

The Committee is an ad-hoc committee which is not subject to the Brown Act. However, the MSC wanted this to be an open and transparent process which was inclusive of all stakeholders. Anyone would have the opportunity to address the Committee. All business is being conducted as if the Committee did have to comply with the Brown Act.

All meeting materials and documents are available on the MCCMC's web site at **www.mccmc.org/penson.html**. There is an e-mail distribution list to notify interested individuals and the meetings have been recorded. Digital copies on audio CDs can be made available upon request.

If these are open meetings for all interested parties, it also includes the media. You can't have it both ways.

I have written one Marin Voice editorial in the Marin Independent Journal. The choice was that I could write it or the IJ would write it. My preference was to control the message and frame the problem. This and any other quotes I have made to the media on this topic are the same statements I have made in MCCMC memos or in the Committee meetings.

Committee Members Too Fiscally Conservative:

Unfortunately, that has been the natural consequence of this issue. To reduce the time spent on educating Committee members on finances and investing, I requested that those who volunteered to represent their cities/towns have some professional background or a strong personal interest in these disciplines. People who understand the general principles of finances and investing tend to be more fiscally conservative.

This same natural consequence would occur on any committee. For example, on the other side, the members on a committee to address the Marin's homeless issues are more socially progressive.

This has been a careful process. The tone and tenor of the Committee's discussion has been collegial and respectful. Interaction going both ways with the public has been civil.

I and members of the Committee have made comments critical of the governance, investment policies, and flaws of the California Public Employees' Retirement System (CalPERS) that have been financially detrimental to the cities/towns. However, at no time has the Committee directed any criticism at public employees individually or collectively.

Not Telling Both Sides of the Problem:

The Committee is studying alternatives to reduce to costs and risks associated with post-employment benefits. The Committee is not studying the work ethic of public employees and the value they have to their respective communities.

These are not opposite sides of the same coin. Any reductions in benefits made on a policy level by a city/town will have an economic an immediate or future impact on their employees. That will be recognized in the final report. But the Committee cannot be artificially encumbered from coming up with a full range of solutions if it has to consider who or what it will impact. That decision will be left to each city/town when they evaluate the alternatives in the context of their own needs and circumstances.

Participation in a Needless Study:

San Rafael is in the Marin County Employees' Retirement Association (MCERA). MCERA reports the participating agency's unfunded liability. CalPERS does not. The participating agency can only get their individual obligations if they file a notice of termination from the system or if they want to switch to a different risk pool.

The report that CalPERS does produce is for the whole risk pool. This is published 14 months after the end of a fiscal year. They have also understated their estimates for payments made by the cities/towns. This has resulted in unexpected and unbudgeted payments to CalPERS.

The scope of the Committee's work is also to identify the unfunded liability of post-employment benefits. This was to be an independent third-party analysis which would incorporate a methodology that could take into account current market dynamics and to produce a range of analyses rather than at a single rate indicative of the target investment return of 7.75%.

Vector Economics was one firm reviewed by a subcommittee. But there were questions raised by the Committee about (1) the marginal benefits of an academic study and (2) the credibility of Joe Nation given his involvement in other political issues.

Bartel & Associates was another firm reviewed by a subcommittee. While their study is smaller in scope and may not provide the tools for fine-tuning an analysis, they have a recognized track record of working with three cities in Marin and over fifty throughout California.

The concept of a joint study was to draw upon any economies of scale that could be achieved for some portion of a study that had common components to all participants. A sample resolution would be drafted to ensure any study is consistent with the scope defined by the Committee. However, participation in any joint study was voluntary and would be decided individually by each city/town.

Conflict of Interest:

I am not an investment professional. At one time in my career, I traded commodity futures.

Because of compliance requirements, I only have small equity holdings in a handful of public companies. These are annually disclosed on my Form 700 filing with the California Fair Political Practices Commission.

I do work in the financial services industry for an investment management firm that is subject to the regulatory requirements under the Financial Industry Regulatory Authority and the Investment Advisory Act of 1940. The firm manages a little over $20 billion in assets in the form of publically traded mutual funds and in separate accounts mirroring the investment strategies of the mutual funds.

The firm is compensated as a percentage of assets under management. The public funds consist of regular cash accounts and self-directed retirement savings accounts such as IRAs and 401(k) accounts. The separate accounts includes public and private pensions whose assets consists of both Defined Benefit Plans and Defined Contribution Plans.

Being in a support capacity, I am compensated on a salary and bonus basis. Part of my bonus is based on meeting my job objectives and part is based on the profitability of the firm.

If there is an immediate and wholesale shift in the public sector from Defined Benefit Plans to Defined Contribution Plans, it is difficult to speculate how it would directly impact the firm. It is not to say it would not see more assets in retirement savings, but it is unknown how much of that would be at the expense of shifting assets from the Defined Benefit business.

Also, we have what is commonly characterized as boutique funds which have a niche appeal. The minimum investment levels are higher and tend to attract a more sophisticated investor.

If you take the most likely and plausible scenario coming out of any kind of reform, it would be additional tiers. Defined Benefit Plans would still exist for current employees whether (1) it is in the current risk pools or one with an older retirement age and/or a lower percentage per year of service or (2) as part of a hybrid plan.

Second, it would seem inevitable that retirees would stay in the same system with any new Defined Contribution assets. Pension systems for education, such as the California State Teachers' Retirement System (CalSTRS), manage both types of plans for their members. CalSTRS encourages and promotes the benefits of keeping 403(b) money invested within their system. Given the general lack of investment knowledge, members tend to stay within the system.

Outcome:

There has been no deviation on what will be delivered to the MCCMC. As we approach the end of the first phase, the report will provide a list of possible solutions which are in the immediate control of a city/town and can be implemented starting with the upcoming budget cycle.

The second phase will compile a list of policy changes to the current system. Implementation of these solutions cannot be achieved without change in legislation, governance, existing contracts, and even the State Constitution.

The information derived from this report will have to go before the MCCMC Legislative Committee for review. Ultimately, the MCCMC will take their preferred solutions to other levels such as the North Bay Division of the League of California Cities where we will join in as part of a larger collective voice. Pension and OPEB reform will be the topic of discussion at their meeting on July 28th.

References (www.mccmc.org/penson.html):

Ken Nordhoff presentation on pension reform (10/28/09)

Larry Chu memo to the MCCMC Mayor Select Committee on the creation of the ad-hoc committee (10/25/10)