



County of Orange

County Executive Office

August 23, 2016

Honorable Charles Margines
Presiding Judge of the Superior Court of California
700 Civic Center Drive West
Santa Ana, CA 92701

Subject: Response to Grand Jury Report, "Orange County's \$4.5 Billion Unfunded Liability & Retirement Plans"

Dear Judge Margines:

Per your request, and in accordance with Penal Code 933, please find County of Orange response to the subject report as approved by the Board of Supervisors. The respondent is the Orange County Board of Supervisors.

If you have any questions, please contact Jessica Witt of the County Executive Office at 714-834-7250.

Sincerely,

Frank Kim
County Executive Officer

Enclosure

cc: ~~FY 2015-16 Orange County Grand Jury Foreman~~
Mark Denny, Chief Operating Officer, County Executive Office
Jessica Witt, Deputy Chief Operating Officer, County Executive Office



Responses to Findings and Recommendations
2015-16 Grand Jury Report:

“Orange County’s \$4.5 Billion Unfunded Pension Liability & Retirement Plans”

SUMMARY RESPONSE STATEMENT:

On June 15, 2016, the Grand Jury released a report entitled: “Orange County’s \$4.5 Billion Unfunded Pension Liability & Retirement Plans.” This report directed responses to findings and recommendations to the Orange County Board of Supervisors and the OC Employees Retirement System, which are included below.

FINDINGS AND RESPONSES:

F.1. **The County, in part, is responsible for the unfunded pension liabilities to increase from a surplus of \$130,000 in 2000 to \$4.5 billion as of December 2012. This represents an increase of more than 4,500% since year 2000.**

Response: *Disagrees partially with the finding.* While benefit changes between 2001 and 2004 contributed to the increased Unfunded Actuarial Accrued Liability (UAAL) at that time, “great recession” market losses and actuarial assumption changes are the principal causes of the increased UAAL between 2000 and 2012. Please refer to the following link to “The Evolution of OCERS Unfunded Actuarial Accrued Liability” posted on OCERS’ website, which details the development of the unfunded pension liability.

http://www.ocers.org/pdf/finance/actuarial/evolution_of_ocers_uaal.pdf

F.2. **The County should have developed a plan to curb the growth in unfunded pension liability independent of OCERS.**

Response: *Agrees with the finding.* The County already executed a plan to curb the growth in UAAL by implementing a hybrid retirement plan prior to implementation of the Public Employees Pension Reform Act (PEPRA) in 2013. The County’s hybrid

plan (1.62% @ 65) is the lowest plan within the State, to control and reduce the growth of the unfunded pension liability.

F.3. The County and OCERS have taken recent actions to control and slightly reduce the unfunded liabilities by 11% from \$4.5 billion in 2012 to \$3.8 billion in 2015, but the County could be more aggressive.

Response: *Agrees with the finding.* The County and OCERS have effectively managed the unfunded liability as the percent funded is within the median range of California peer governmental units, as identified in the report (pages 4 and 7). The County will continue to review annually, through the Strategic Financial Plan, if it is economically and operationally feasible to take specific steps to further reduce the unfunded liability.

F.4. Issuing short term Pension Obligation Bonds (7 of past 10 years) to achieve taxpayer's savings of over \$100 million during the past decade was a good decision by the County.

Response: *Agrees with the finding.*

F.5. OCERS Board of Retirement made a solid financial decision to reduce the amortization period of the UAAL from 30 years down to its current period of 20 years, resulting in increased annual payments from the County.

Response: *Agrees with the finding.* The County agrees that the decision by the OCERS Board of Retirement to reduce the amortization period of the UAAL from 30 years to 20 years was a sound financial decision, as it ensures a more timely payment of the UAAL, eliminating an additional ten years of interest payments.

Simply due to timing, with the bulk of the County's 30-year amortized UAAL already having reached slightly below the 20 year mark, the restart of the amortization period at 20 years lead to a modest initial decrease in the County's contribution payments. However, any UAAL that may arise in the future from actuarial assumption changes will now be funded over a 20-year period, instead of the prior policy's 30-year amortization schedule.

F.6. Passage of the state Public Employees' Pension Reform Act of 2013 should improve the financial stability of the County's retirement system.

Response: *Agrees with the finding.*

F.7. The State and local governments have the ability to implement Defined Contribution Plans, or hybrid plans, instead of the traditional Defined Benefit Plan. Much of the private sector has transitioned to the Defined Contribution Plans such as 401K plans and more than 30 jurisdictions in California use

Defined Contribution Retirement Plans, including Orange County.

Response: *Disagrees partially with the finding.* The County has already implemented a hybrid plan, which combines a defined benefit plan (1.62% @ 65) administered by OCERS and a defined contribution plan administered by a third party administrator. The hybrid plan does not conflict with the California Employees Retirement Law of 1937 (CERL). The County does not have the authority to close the defined benefit plan to new members. A legislative change would be required for a County operating under CERL to close its defined benefit plan to new members and current members would be prevented from moving from a defined benefit plan to a defined contribution plan due to California vested rights law.

F.8. **County employees are not treated equally as relates to retirement benefits. Orange County utilizes and contributes to several Defined Contribution Plans as supplemental retirement plans to OCERS and one of the plans is restricted to “select” employees and all elected County officials. Additionally, the County has eight non-County employees in the exclusive 401(a) plan.**

Response: *Agrees with the finding.* As noted in the report (page 16), the 401 (a) Defined Contribution Plan is a component of the compensation package provided to certain eligible classifications within the County, which is consistent with CERL. Additionally, based on bargaining with various labor unions, County employees may be entitled to differing Defined Benefit and Defined Contribution Plans for retirement benefits.

F.9. **Orange County has not designated unfunded liability reduction as a priority either by action or in its Strategic Financial Plan.**

Response: *Disagrees partially with the finding.* The County has supported actions taken by the OCERS Board to amend actuarial assumptions, to ensure a sound, well-funded retirement system. The County has also demonstrated support through Board of Supervisors appointments to the OCERS Board that are consistent with the County’s philosophy of prudent fiscal stewardship.

The County’s annual Strategic Financial Plan and budget processes are essential tools that prioritize budget stabilization and strategically plan to address the County’s current and future needs. Ensuring a sound, well-funded retirement system is a critical component of the existing County finance processes.

RECOMMENDATIONS AND RESPONSES:

R.1. **The County should encourage the OCERS Board of Retirement to maintain financially sound assumptions and to oppose any relaxation of current assumptions. (F1)(F3)**

Response: *The recommendation has been implemented.* The County continues to work closely with OCERS on a routine basis and provides input, as warranted, to ensure decisions are based on accurate and relevant assumptions and experience.

R.2. The County should establish and adopt a plan, working with OCERS, to increase the pension percent funded liability to 80% from its current level of 70% by making additional payments to OCERS. This plan should be developed as part of the County Strategic Financial Plan is being updated in late summer 2016. As the 2017-2018 budget is being developed, the first advance payment of the Plan should be included. (F1) (F2)

Response: *The recommendation will not be implemented because it is not warranted.* The County already works with OCERS to receive an annual 20-year forecast for achieving the 80% funded ratio. The OCERS Board approved the actuarial valuation as of December 31, 2015 on July 18, 2016, so the County expects to receive the most current 20-year forecast in the very near future. The 20-year forecast based off the December 31, 2014 actuarial valuation assumed an 80% funded ratio as of 2020. The most current actuarial valuation reflects an improvement in the funded ratio from 70% to 72%. The County's 2015 Strategic Financial Plan indicates the County does not have the ability to consider any additional payments to OCERS until the remaining \$130 million owed to the State as a result of the VLFAA lawsuit are made through FY 2018-19. The County will continue to re-evaluate its ability to make additional payments annually with completion of the Strategic Financial Plan.

R.3. The County should develop a policy to continue issuing short term Pension Obligation Bonds, so long as the discount from OCERS is available and there is enough net savings (which should be defined) after paying for cost of issuance and underwriter's discount. (F4)

Response: *The recommendation has been implemented.* The County will continue to participate in the early payment of employer contributions program assuming the OCERS Board approves continuation of the program and there is a net benefit to the County.

R.4. The County should direct its lobbyists or work through the California State Association to find support in the legislature for a bill with additional pension reforms, beginning with the next legislative session that would further reduce the impact of unfunded pension liabilities. (F6)

Response: *The recommendation will not be implemented because it is not warranted.* The County has an obligation to those vested into the current pension models and currently offers a hybrid plan (1.62% @ 65) that meets the requirements of PEPR, and is the lowest retirement plan in the State.

R.5. The County should conduct a thorough analysis including the financial impact of implementing a Defined Contribution Retirement Plan or a hybrid plan, replacing the current Defined Benefit Plan, before January 2017. (F1) (F7)

Response: *The recommendation has been implemented.* The County does not have the authority to replace the defined benefit plan for new members. A legislative change would be required for a County operating under CERL to close its defined benefit plan to new members and current members would be prevented from moving from a defined benefit plan to a defined contribution plan due to California vested rights law. The County implemented a hybrid retirement plan prior to implementation of PEPRRA. The County's PEPRRA retirement plan (1.62% @ 65 Hybrid Benefit Plan), the lowest in the State, is aimed at controlling and reducing the growth of the unfunded pension liability.

R.6. The County should review the current practice of using taxpayer money to benefit eight non-County employees through the 401(a) retirement plan by the end of 2016. (Executive Director LAFCO; Executive Manager- Children & Family Commission and six OCERS executives). (F8)

Response: *The recommendation will not be implemented because it is not warranted.* OCERS, LAFCO, and Children and Families Commission, not the County, are responsible for determining and reviewing compensation packages provided to their employees. The salaries and benefits of those employees are paid for directly by those agencies.

R.7. The Board of Supervisors should, by the end of calendar year 2016, publicly revisit and determine if the Executive Compensation package 401(a) supplemental retirement plan for 44 County elected officials and top executives is still justifiable. (F8)

Response: *The recommendation will not be implemented because it is not warranted.* The 401(a) supplemental retirement plan is a component of total compensation that is required to attract and retain qualified and experienced employees.