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September 17, 2010

To: Supervisor Gloria Molina, Chair
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From: William T Fujioka
Chief Executive Officer

REPORT ON OPTIONS TO REFORM THE COUNTY PENSION SYSTEM

At the Board of Supervisors meeting held June 29, 2010, during the discussion of Agenda Item No. 70, Supervisor Antonovich requested the Chief Executive Office report back on ways of reforming the County pension system to reduce costs, and provide a projection of how many County employees, who are active participants in Los Angeles County pension plans "A", "B" and "C", will be retiring in the next five years. This memo addresses both requests.

Los Angeles County Pension System

Over 30 years ago, Los Angeles County began reforming its pension system to maintain a financially stable retirement program. In the seventies, the County had two retirement plans with enhanced benefits: Safety Plan A and General Plan A. Over the years, in an effort to bring financial stability to the retirement system, the County closed these and other plans to new employees. Currently, Los Angeles County has three retirement plans open to new employees: Safety Plan B and General Plans D and E.

The County's retirement plans are administered by the Los Angeles County Employees Retirement Association (LACERA).

Los Angeles County Employees Retirement Association

LACERA is the largest county retirement system in the United States with assets over $40 billion. LACERA has over 157,000 members, including more than 53,000 retirees, and has been providing retirement benefits to retired County employees for over 70 years.

Most governmental entities in the State offer a retirement for safety members of "three percent at 50" benefit which provides a retiree beginning at age 50 an annual pension of three percent of their highest annual salary multiplied by the number of years served. Los Angeles County has a "two percent at 50" formula for its safety members.

The County retirement benefits for non-safety employees also offer modest pension benefits. General members in LACERA Plan D earn a "two percent at 61" benefit, while employees in Plan E earn a "two percent at 65" benefit. In comparison to other governmental agencies in the State, the County's general member plans offer very modest pension benefits.

Pension Roll-Backs at the State

Recently, the State reached agreements with six of its unions representing approximately 37,000 employees pursuing pension reform by rolling back pension benefits to 1999 levels. The unions reaching agreement with the State were:

- California Association of Highway Patrolmen
- California Association of Psychiatric Technicians
- Union of American Physicians and Dentists
- International Union of Operating Engineers
- California Department of Forestry Firefighters
- American Federation of State, County and Municipal Employees

Below is a brief description of the pension reform the State made with its unions.

Changed the Final Compensation Period from One-Year to Three-Years for New Employees

Final compensation is the highest average pay rate including any special compensation for a period of employment. Final compensation, years of service, and the retirement formula are used to determine the employee's retirement amount.

For new employees, the State increased the final compensation period from one year to three years.

Rolled Back Retirement Formulas Used to Calculate Pension Payments for New Employees

The State also rolled back the retirement formulas used to calculate pension payments by requiring new employees to work additional years to receive full benefits. For some safety classifications the retirement formula was increased from "three percent at 50" years of age to "three percent at 55" years of age. For other general positions the benefit was increased from "two percent at 55" years of age to "two percent at 60" years of age.

Increased the Employee Retirement Contribution for Current and New Employees

The State negotiated an increase in the employee retirement contributions with the six unions from approximately five percent of salary to ten or eleven percent of salary for current and new employees. In the State's negotiation with its unions, the State also reduced or eliminated furlough days for employees and/or agreed to salary increases in 2012. The State is continuing negotiations with its remaining unions.

Los Angeles County Potential Pension Reforms to Reduce Costs

We have reviewed the pension roll-backs at the State and compared them to the County's current pension benefits. The following represents that comparison:

Change Final Compensation Period from One-Year to Three-Years for New Employees

The County provides defined pension benefits to its members based on age at retirement, year of service credit, and final compensation. For LACERA Safety Plan B and General Plan D, final compensation is the monthly average of a member's compensation during their highest year of service. Plan E is an employee non-contributory plan with a three year final compensation period.

In 2002, after negotiations with County unions, the County modified the final compensation period from three years to one year for Safety Plan B and General Plan D. The County could negotiate a return to three year or another final compensation period.

Basing final retirement compensation on the highest three years of wages, instead of the highest year for employees, reduces the incentive for employees to increase their salaries in the last year of work to increase their pension. If the final compensation period were changed for new employees, this reform could potentially save the County over $100 million annually when this group of employees retires, and reduce the County's pension obligation by $2.3 billion.

Increase Retirement Formulas Used to Calculate Pension Payments for New Employees

LACERA Safety Plan B and General Plan D allows County employees to retire at age 50 with at least 10 years of County service. General Plan E allows employees to retire at age 55 with at least 10 years of County service. The retirement formula for these plans is as follows:

LACERA Retirement Plan	Age at Retirement	Retirement Benefit
Safety Plan B	50	2.0%
General Plan D	61	2.0%
General Plan E	65	2.0%

As previously mentioned, the County's safety retirement formula of two percent at 50 is the lowest in the State since most other retirement plans offer a three percent at 50 benefit. The County General Plan D with a two percent at 61 years of age formula and General Plan E with a two percent at 65 years of age formula are also among the lowest general member retirement benefit plans in the State.

If a County employee retires at the earliest retirement age allowed by his retirement plan, the retirement percentage is actuarially reduced and provides limited pension benefits. Below is an example of a 25 year County employee who retires at the earliest retirement age in their respective plan.

LACERA Retirement Plan	Earliest Retirement Age	Benefit Percentage with 25 Years of Service
Safety Plan B	50	50.0%
General Plan D	50	29.6%
General Plan E	55	18.7%

A Safety Plan B member would receive a safety retirement of 50 percent of their salary at age 50. This same scenario for a General member in Plan D retiring at age 50 allows the member a retirement benefit of 29.6 percent of their salary and a General member in Plan E retiring at age 55 would receive an 18.7 percent benefit.

Increasing the minimum retirement ages for Safety Plan B, and General Plans D and E yields very little cost savings since these Plans already offer very modest retirement benefits at the minimum retirement age.

Increase Employee Retirement Contributions for Current and New Employees

To reduce costs, a number of governmental entities in California, including the State, have or are considering increasing employee retirement contributions. As described earlier, the County has two open employee contributory plans: Safety Plan B and General Plan D.

Except for a three percent negotiated subsidy in Safety Plan B, both plans require the County and employee to pay 50 percent of the cost of the plan, including 50 percent of the cost-of-living benefit. The Safety Plan B three percent subsidy requires the County to pay the first three percent of the cost of the plan and then the remainder of the cost is split between the County and employee.

Under State law, the County cannot require employees to pay more than 50 percent of the cost of Safety Plan B and General Plan D. The County could, however, negotiate a lower subsidy for Safety Plan B or could support change in State law.

If the County eliminated the Safety Plan B three percent subsidy for current employees, this reform could potentially save the County $41 million a year now. If the subsidy were eliminated for new employees, this reform could potentially save the County over $100 million annually when this group of employees retire from County service.

Other Options (Not in Comparison to the State)

Explore a "Cash Balance" Defined Benefit Plan for New and Existing Employees

A "Cash Balance" plan is a hybrid that encompasses the characteristics of a defined-benefit plan, such as LACERA, with a defined contribution plan, such as a 401(k) plan. Cash balance plans can provide retirement security for employees and fiscal stability for the employer.

Cash balance plans have two features. The employer contributes a percentage of an employee's salary into an account that belongs to the employee; however, unlike a defined contribution plan, the employer also guarantees a stated annual rate of return (such as five percent) for the employee.

Cash balance plans have advantages to the employee. Employees can change jobs and take their cash balance retirement plan with them. Also, the rate of return in the cash balance plan is guaranteed by the employer, so the employee does not bear the risk of stock market fluctuations. At retirement, employees can take the balance in their cash balance plan accounts as an annuity or choose a lump sum benefit.

For the employer, cash balance plans reduce the risk of pension underfunding. Many governmental pension plans in the State are underfunded and looking for cost saving measures to reduce these deficits.

Under a cash balance plan, the County would only be liable to make defined contributions to the plan and pay the guaranteed rate of return on each employee's cash balance account. Currently, only a limited number of governmental entities have implemented cash balance plans. Further analysis would be required to determine the feasibility of implementing such a plan in the County.

Summary

Cost savings can be achieved by modifying the final compensation period for Safety Plan B and General Plan D from a one year final compensation period to a three year or other final compensation period. Additionally, reducing the County's three percent subsidy for Safety Plan B to a lower percentage could also produce savings.

The County cannot increase employee contributions to Safety Plan B (excluding the three percent subsidy) and General Plan D since these plans already require the employee to contribute the maximum allowable by law. Increasing the retirement ages for Safety Plan B, and General Plans D and E would yield very minimal results since the benefit percentages are already low and retirement ages relatively high compared to other governmental retirement plans in the State.

Employees in Retirement Plans A, B, and C Expected to Retire in the Next Five Years

Currently, there are 2,421 active employees in Safety Plan A and in General Plans A, B, and C. Of those employees, 2,369 (97.9%) can retire now based on their age. In the next five years, we expect nearly all of the employees in those plans to retire since members in Plan A, B and C will have at least 38, 37, 36 years of service respectively. Presently, the average employee retires with 24 years of County service.

If you have any questions or need additional information, please have your staff contact James Adams at (213) 974-2406.

WTF:BC:
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c: Executive Officer, Board of Supervisors