VENTURA COUNTY EMPLOYEES' RETIREMENT PLAN

Summary

Recent newspaper articles have described public sector pension plans as threatening the long-term fiscal stability of their government sponsors. [Ref-03, Ref-04, and Ref-05] The pension-related financial problem of the City of San Diego was only one of several cited in the news. The 2006-2007 Ventura County Grand Jury (Grand Jury) therefore decided to examine the Ventura County employees' retirement plan (Plan).

The Plan is a defined benefit plan, providing guaranteed benefits to employees of Ventura County and a few other local agencies. The Grand Jury determined that the Board of Supervisors (BOS) does not receive regular briefings on the status of the Plan although the County is ultimately responsible for paying the Plan's benefits. In the past six years, the funded status of the Plan has changed from a surplus of $368 million to a deficit of $482 million because:

- Employee compensation has increased greater than projected.
- The Plan's investment portfolio has performed worse than projected.
- Employees are retiring younger and living longer than projected.

When the Ventura County Employees' Retirement Association (VCERA) determines the County's annual contributions to the Plan, those contributions are not funded for more than one year. Additionally, VCERA has increased the time during which the County is allowed to "pay down" the deficit. The Grand Jury found that, while County employees pay part of the cost of their retirement benefits, the County is actually "picking up" a significant part of the employees' share in addition to paying the employer's share. The Grand Jury noted that the City of Oxnard established a pension reserve account when their plan's surplus eliminated required payments into their plan. In a similar situation, Ventura County spent the funds elsewhere in its operating budget instead of creating a reserve.

The Grand Jury concluded that insufficient information is given to the BOS regarding how increases in employee compensation affect the funded status of the Plan. The fees for investment advisors paid by VCERA increased substantially while the Plan's investment portfolio failed to achieve its projected earnings. The Grand Jury concluded that VCERA delays the effective dates of its funding decisions, which might magnify funded status deficits or surpluses.

The Grand Jury determined that the long-term impact of the Plan on Ventura County budgets would be improved if certain recommendations are implemented. These recommendations include the following:

- Regular reports should be presented to the BOS on the current status of the Plan.

- BOS actions to increase employee compensation should be monitored more closely to ensure that the cumulative increases do not exceed the Plan's actuarial assumptions.
- The time lag between VCERA determining the Plan's contribution rates and those rates being funded should be reduced.
- The period over which funded status deficits or surpluses are amortized should also be reduced.

Background

Most public sector employees in the United States receive some form of retirement benefits from their employers. Usually, the benefit is a pension from a defined benefit plan (F-08). Often this is supplemented with a defined contribution plan (F-09). Some governmental agencies are studying the replacement of their defined benefit plans with defined contribution plans.

Methodology

The Grand Jury interviewed two Ventura County Supervisors, a past member of the Ventura County Employee Retirement Association (VCERA) Board, and Ventura County and VCERA management employees. The Grand Jury reviewed VCERA annual reports and Ventura County budgets. Jurors attended a public briefing to the Ventura County Board of Supervisors by the VCERA actuary on March 6, 2007, and reviewed the printed materials distributed at that meeting. The Grand Jury conducted a protocol visit to the City of Oxnard and was briefed by the City Manager on issues that included the City's finances.

Findings

The Ventura County Employee Retirement Association

F-01. The Ventura County employees' retirement plan (Plan), established by the County in 1947, is a defined benefit plan organized under the County Employees Retirement Act Of 1937 ('37 Act, California Government Code §31450 et seq.). The Plan is governed by a third-party agency known as the Ventura County Employees' Retirement Association (VCERA) which serves as administrator and fiduciary for the pension plan trust fund.

F-02. The Plan includes all full-time county employees, Court staff (except Judges), County Supervisors, VCERA staff, and the employees of certain Special Districts.

F-03. VCERA is governed by a nine-member retirement board comprised of:

- County Treasurer-Tax Collector
- one County Supervisor
- three public members appointed by the Board of Supervisors (BOS)

- one County employee elected by safety employees (e.g., employees of the Sheriff, District Attorney, Fire Department)
- two County employees elected by non-safety employees
- one County retiree elected by the retirees in the Plan

F-04. Qualifications for the four elected VCERA director positions require only that they be elected by their group. No knowledge of accounting, finance, investments, or pension issues is required.

F-05. Public members are recommended by the County Executive Officer (CEO) and approved by the BOS. One public member has served over 40 years in that capacity; another public member has served over ten years.

F-06. The California Constitution (Article XVI, §17(b)) provides that members of a retirement board of a public pension or retirement system must discharge their duties with respect to the system solely in the interests of, and for the exclusive purposes of:

- providing benefits to participants and their beneficiaries
- minimizing employer contributions thereto
- defraying reasonable expenses of administering the system

F-07. The decisions made by the VCERA Board include assumptions of future inflation; interest rates; and asset allocation of stocks, bonds, and real estate. Additionally, the Board determines which investment advisors, actuaries, and auditors will be retained.

Retirement Benefits

F-08. A defined benefit plan is a retirement plan that specifies the benefits each employee receives at retirement. In most plans, the benefit is stated as a percentage of pre-retirement compensation, which is payable for the participant's remaining life. The defined benefit plan provides a fixed predetermined benefit that has an unknown cost to the employer.

F-09. A defined contribution plan is a retirement plan in which employer contributions are allocated to the accounts of individual employees. One example is a 401(k) plan. The defined contribution plan has a predetermined cost to the employer and provides an unknown benefit to the employee, based upon the rate of return.

F-10. Ventura County and the special districts involved in the Plan guarantee retirees and their beneficiaries lifetime annuities in a defined benefit plan. Payments are generally a function of:

- years of employment with the County (plus reciprocity and buybacks)
- age at retirement
- final credited compensation

Ventura County also provides employees with a voluntary 401(k) plan.

F-11. Final credited compensation may include salary (excluding overtime pay), shift differential, auto allowance, vacation redemption, flexible benefit credit, education incentive, and County-paid employee pension contribution.

F-12. Monthly retirement benefits are calculated by a VCERA staff analyst, verified by a staff supervisor, re-verified after data entry, and subsequently sample-checked by VCERA's independent auditors.

Plan Oversight

F-13. The BOS does not receive a regularly scheduled briefing on the financial condition of the Plan.

F-14. The BOS is not responsible for the amount of required annual contribution, investment of assets, or the administration of the Plan. These decisions are the responsibility of VCERA.

F-15. The elected County Auditor-Controller performed the VCERA audit until 1992, when Proposition 162 gave retirement boards more autonomy. Since that date, an independent CPA firm selected by the VCERA Board has performed the audit. VCERA began using an independent CPA firm because the Auditor-Controller is part of County government, and thus a conflict of interest could exist.

Plan Funding and Performance

F-16. Neither the BOS nor VCERA management agrees on how low the funded ratio can fall before they would become concerned. The number varied from 70% to 80%.

F-17. The BOS approves current employee compensation and benefits, often without receiving a thorough written analysis of future impacts on funding the Plan.

F-18. Funded status (assets minus liabilities) of the plan decrease when:

- Investment earnings are less than projected.
- Salary increases are greater than projected.
- Employees retire earlier or retirees live longer than projected.

F-19. The annual report issued by VCERA for the period ended June 30, 2006, [Ref-01] disclosed that the funded ratio (assets divided by liabilities) decreased from 123% on June 30, 2000, to 83% over the six-year period.

F-20. This six-year reduction in funded ratio is equivalent to a decrease in funded status from a positive $368 million to a negative $482 million – an $850 million net change. (See Attachment 1.) Components of this change were:

- $99 million from salary and wage increases in excess of actuarial assumptions and unbudgeted headcount additions (See Attachment 2.)
- $426 million from investment earnings less than the expected 8% actuarial assumption

- $325 million from demographics (disability retirements, age at retirement, employee turnover, and longevity in retirement) not in accord with actuarial assumptions

F-21. An increase in the value of the Plan assets because of investment appreciation increases the funded status. At times, this has permitted an enhancement of benefits paid to retirees. Some of these enhancements include:

- $108.44 per month to all retirees, effective January 15, 1991. This enhancement is vested for all retirees.
- STAR COLA, effective October 1, 1997. Special payments for employees who retired prior to April 1981 and lost over 20% of the purchasing power from their retirement benefit because of inflation. This benefit is non-vested and must be approved annually.
- $27.50 to all retirees, effective March 17, 2003. This amount is non-vested and can be discontinued.

F-22. Benefits paid to retirees and the number of retirees both continue to increase. For the six years ended June 30, 2006, the number of retired members collecting benefits increased from 3,520 to 4,570, while the number of active members in the Plan remained constant at 7,403.

F-23. For the three years ended June 30, 2006, all VCERA equity (stock) and real estate investments underperformed their benchmarks (goals).

F-24. During the same three year period, investment management fees paid by VCERA increased from $5.6 million to $7.2 million per year.

F-25. The increase in costs for investment management was the result of retaining additional managers for VCERA's real estate holdings.

F-26. The Board of VCERA has discussed moving more of the equity portfolio from active to passive management, thereby reducing investment fees.

F-27. The decision on changing actuarial assumptions might sometimes be driven by political considerations.

F-28. VCERA determines Ventura County's contribution rates early in the calendar year. However, changes in the contribution rates do not become effective until the fiscal year beginning in the following calendar year, 12 to 18 months later.

The Cost of the Plan

F-29. Employee contributions for the Plan are currently established at 11.50% of compensation for safety employees and 5.35% for non-safety employees.

F-30. It is customary in governmental defined benefit plans for employees and the employer to share in the cost of the program.

F-31. The BOS in various labor negotiations has agreed to pay some or all employee contributions to the Plan. This agreement is negotiated periodically for a finite period of time.

F-32. In fiscal year 2004-2005, the County contributed $25.8 million on behalf of employees as the negotiated vested and non-vested "pickup" of employee contributions.

F-33. In fiscal year 2005-2006, the County contributed $26.8 million on behalf of employees as the negotiated vested and non-vested "pickup" of employee contributions.

F-34. During the three years ended June 30, 2003, while the Plan's funded status fell from a surplus of $368 million to a deficit of $145 million — a $513 million net change — VCERA did not require any normal (current) employer contributions to the Plan. Ventura County made no employer contributions during this period.

F-35. During this three year period, when the County made no employer contributions, the total required employee contributions were $70.6 million, of which the County paid $60.6 million as its negotiated "pick-up" of employee contributions.

F-36. The California Public Employees Retirement System (CALPERS) required no normal contributions from the City of Oxnard during approximately the same period cited in F-36. During this period, Oxnard chose to apply the money saved to a reserve for future contributions.

F-37. The County annual pension expense includes the normal cost and the amortization of any deficit in funded status. VCERA informs the CEO and the BOS each year how much the County must contribute to the plan for the ensuing fiscal year.

F-38. VCERA does not evaluate specific BOS actions relative to compensation and layoffs to determine if they are within the Plan's actuarial assumptions.

F-39. In 2003, the VCERA Board approved a reduction in the assumed rate of return on investments from 8.25% to 8%. This reduction was estimated to have caused an increase of 2.5% of payroll in annual normal pension costs charged to the County plus a significant increase in the funded status deficit.

F-40. Deficits in the funded status are amortized as a level percentage of payrolls, payable by the County over a 15-year period. Each year, new deficits are amortized over a new 15-year period.

F-41. The June 30, 2004, VCERA annual report [Ref-02] disclosed that the unfunded liability of the Plan had doubled in one year from a negative $145 million to a negative $323 million.

F-42. On August 16, 2004, the VCERA Board increased the amortization period from 10 years to 15 years, which decreased the County's annual pension costs.

F-43. On May 15, 2006, the VCERA Board considered an agenda item to further reduce the actuarial assumption of the rate of investment returns. The actuary suggested a range of 7.75% to 8%. By a vote of 5-4, the Board agreed to keep the rate at 8%. The cost of this actuarial change to the County would have been similar to that noted above in F-41.

F-44. The Plan uses an ongoing five-year “smoothing” of the difference between actual investment results and the expected investment return.

F-45. The total unrecognized investment gain as of June 30, 2006, is $174 million. As a result of smoothing, this amount will be recognized over the next five years.

F-46. VCERA, with its own governing board, is an independent governmental entity separate and distinct from the County of Ventura.

F-47. The County borrowed $154 million in 1995 in the form of Pension Obligation Bonds (POBs). This new debt covered a deficit in the Plan’s funded status.

F-48. POBs had the effect of exchanging the County’s obligation to VCERA for the deficit in the funded status for an increase in the County’s debt load.

F-49. POBs are debt instruments that the County has used to fully fund a shortfall in the Plan in a single payment. This debt is repaid with interest over a 15-year period.

F-50. POBs will cost the County $20 million in interest and principal in 2006-2007 with a final payment of $12 million due in 2007-2008.

F-51. Ventura County has no plans at this time to use POBs for meeting its obligations to the Plan.

Conclusions

C-01. The Board of Supervisors (BOS) has not been routinely briefed on the details of the Ventura County employees’ retirement plan’s (Plan) funded status. As a consequence, the public may be unaware that the Plan’s funded ratio has fallen from 123% (a surplus) to 83% (a deficit) in a span of six years. During three of the six years, the County was not required to, and did not make, any normal employer contributions to the Plan. (F-13, F-16, F-17, F-19, F-20)

C-02. The funded status of the Plan changed by $850 million in the past six years, from a surplus of $368 million to a deficit of $482 million. The deficit is largely due to lower investment returns, salary and wage increases, and demographic issues, all three of which fell outside the range of the actuarial assumptions approved by the Board of VCERA. (F-18, F-20, F-38)

C-03. Ventura County could have established a reserve account when no employer normal contributions were required (similar to the reserve the City of Oxnard established). Reserve funds could then have been contributed to the Plan to cover funded status deficits in later years rather than impacting current operating budgets. (F-18, F-34, F-36, F-37)

C-04. The Board of VCERA has been slow in changing actuarial assumptions to reflect actual experience. Had VCERA made recommended changes in a timely manner, larger contributions to the Plan would have been required from the Ventura County budget. Instead, VCERA approved a plan in 2004 to lengthen the amortization period of funded status deficits, which helped to reduce required annual pension contributions from the County's operating budget. (F-06, F-20, F-27, F-39 through F-45)

C-05. Investment advisor fees have increased from $5.6 million to $7.2 million per year on VCERA's actively managed portfolio. However, investment performance of this portfolio over the past three years has been less than the actuarial expected 8% return. (F-06, F-07, F-23 through F-26)

C-06. While salary increases, pension plan enhancements, and negotiated "pickup" of employee contributions may have a known immediate fiscal impact, the resulting increase in future County-guaranteed pension plan obligations may pose an additional and increasing burden to the County's future budgets. (F-02, F-11, F-21, F-29 through F-33)

C-07. When there is a shortfall in invested Plan assets (the result of a funded status deficit), there might be a corresponding shortfall in investment earnings. Delays in payments towards reducing a funded status deficit may increase the deficit by delaying additions to VCERA's investment portfolio and thus increase pension costs in future Ventura County budgets.

When there is an excess of invested Plan assets (the result of a funded status surplus), there might be a corresponding excess of investment earnings. Delays in recognizing a funded status surplus may similarly increase the surplus and thus impose unnecessary pension costs on the current Ventura County budget.

Whether there is a surplus or deficit in the funded status, any delay in correcting that condition can thus magnify it and have an adverse impact on Ventura County budgets. (F-06, F-18, F-19, F-28, F-37)

C-08. There are both positive and negative factors for employers offering defined benefit plans. The employer bears all the risk from the plan's investment decisions, but the employer can reduce retirement plan contributions if those decisions yield more investment earnings than expected. The employer also bears the risk if retired employees live longer than expected but gains if retirees do not live to their actuarially projected age. Thus, when actual experience differs from actuarial assumptions, all risks or rewards fall on the employer.

With defined contribution plans, those same factors apply to employees. Employees bear all the risks and rewards from their investment decisions. Similarly, the employee bears the risk that he or she might outlive the invested funds; but his or her heirs receive any remaining funds if the employee does not fully utilize them before death. Thus, when actual experience differs from expectations, all risks or rewards fall on the employee. (F-08, F-09, F-10, F-22)

C-09. Salary increases for Ventura County have been averaging more than VCERA's actuarial assumptions: $99 million during the past six years. (F-17, F-20, F-38)

C-10. When a local government issues pension obligation bonds (POBs) to make payments into its pension plan, it is merely converting a pension liability into a general liability. The Plan's funded status is improved by POBs, but the government's overall liability for its pension plan remains unchanged. The use of POBs thus complicates the ability of taxpayers, government employees, and elected officials to compare the relative strengths of different pension plans and to comprehend the "real" unfunded liability. (F-47 through F-51)

Recommendations

R-01. The Ventura County Employees' Retirement Association (VCERA) should provide annual public reports to the Board of Supervisors (BOS) on the status of the Ventura County employees' retirement plan (Plan). Each report should include:

- current actuarial assumptions relating to compensation increases, investment earnings, and demographics
- details about variances between those actuarial assumptions and the past year's actual experiences
- changes in assumptions recommended by VCERA's actuary, with explanations of why any of those assumptions were not adopted by the VCERA Board
- a long-term forecast of the Plan's funded ratio
- fees paid to investment advisors and how those fees relate to the performance of VCERA's investment portfolio

(C-01, C-04, C-05)

R-02. The BOS should establish a Pension Reserve account. When VCERA does not require employer normal contributions to the Plan, an amount at least equal to the previous year's employer normal contribution should be transferred into the Pension Reserve from the County's current operating budget. When a funded status deficit occurs in the Plan, Ventura County should make payments to the Plan for that deficit from the Pension Reserve account. (C-02, C-03)

R-03. Actions by the BOS to change employee compensation and employment levels should be monitored by the County Executive Officer (CEO) on an ongoing basis for consistency with VCERA's actuarial assumptions. When the cumulative effects of BOS actions fall outside the range of actuarial assumptions, the BOS should be notified immediately. (C-02)

R-04. The BOS should increase the emphasis on its defined contribution plan (401(k)) in the County's retirement benefits. (C-08)

R-05. The BOS should eliminate the “pickup” of employee contributions to the Plan when current employee agreements expire. (C-06)

R-06. VCERA should return to the use of 10-year amortization of deficits or surpluses in the Plan’s funded status, thus avoiding growing deficits or surpluses that may occur when corrective action is delayed. (C-04)

R-07. When VCERA determines changes in required contributions to the Plan, the changes should become effective in the County’s next fiscal year’s budget. The current extra year’s delay in the funding of those changes must be eliminated. (C-07)

Responses

Responses Required From:

Ventura County Board of Supervisors: R-02, R-04, R-05

Ventura County Employees’ Retirement Association: R-01, R-06, R-07

Responses Requested From:

Ventura County Chief Executive Officer: R-03

References

Ref-01. *Comprehensive Annual Financial Report For the Fiscal Year Ended June 30, 2006*; Ventura County Employees’ Retirement Association.

Ref-02. *Comprehensive Annual Financial Report For the Fiscal Year Ended June 30, 2004*; Ventura County Employees’ Retirement Association.

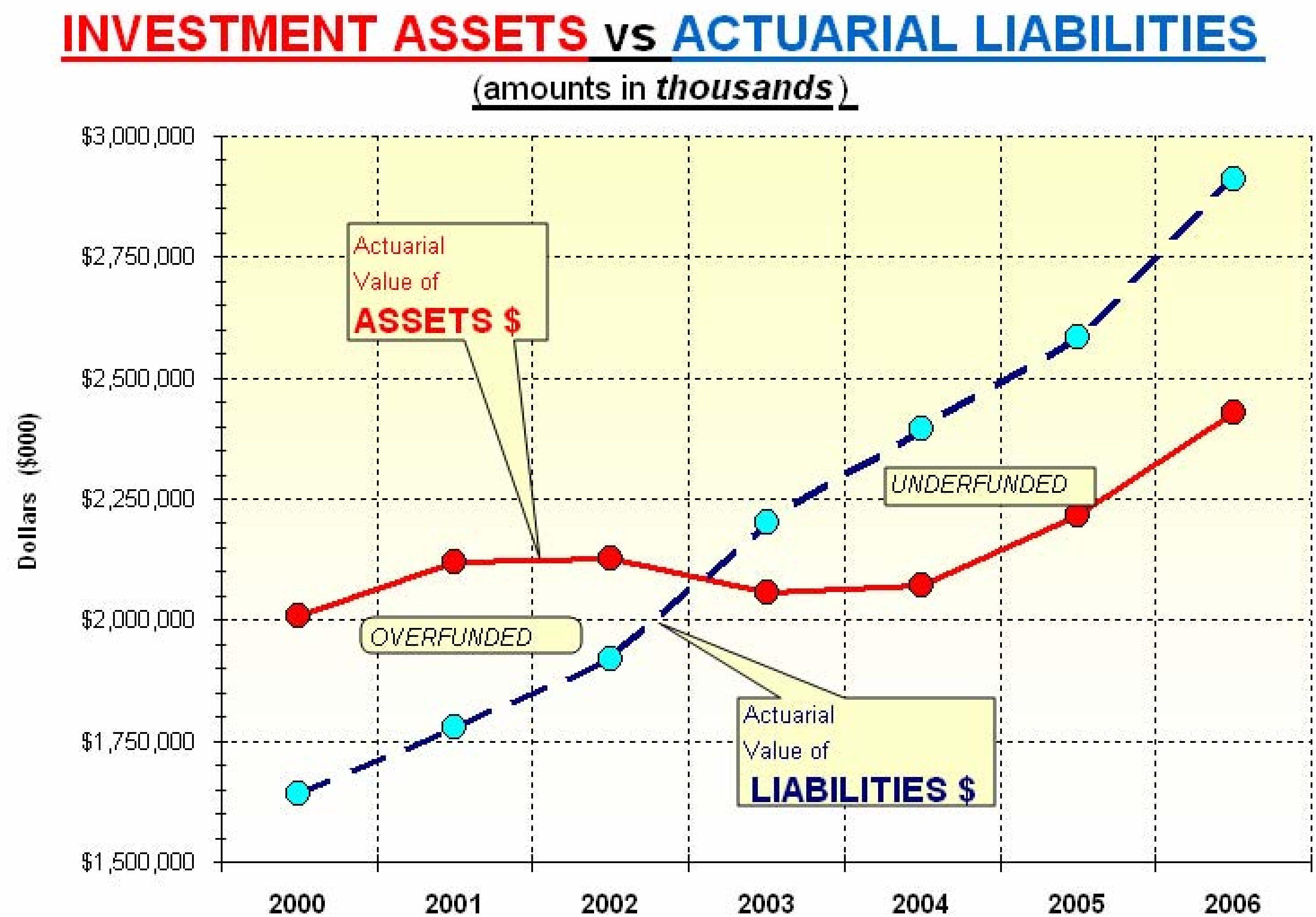
Ref-03. “Board OKs Pension Benefit Study”, *Los Angeles Times*, October 4, 2006

Ref-04. “Public Employee Pensions”, *Pension Watch*, Web site at <http://www.pensiontsunami.com/public.php>

Ref-05. “Public Pension Price Tag”, *Wall Street Journal*, August 21, 2006

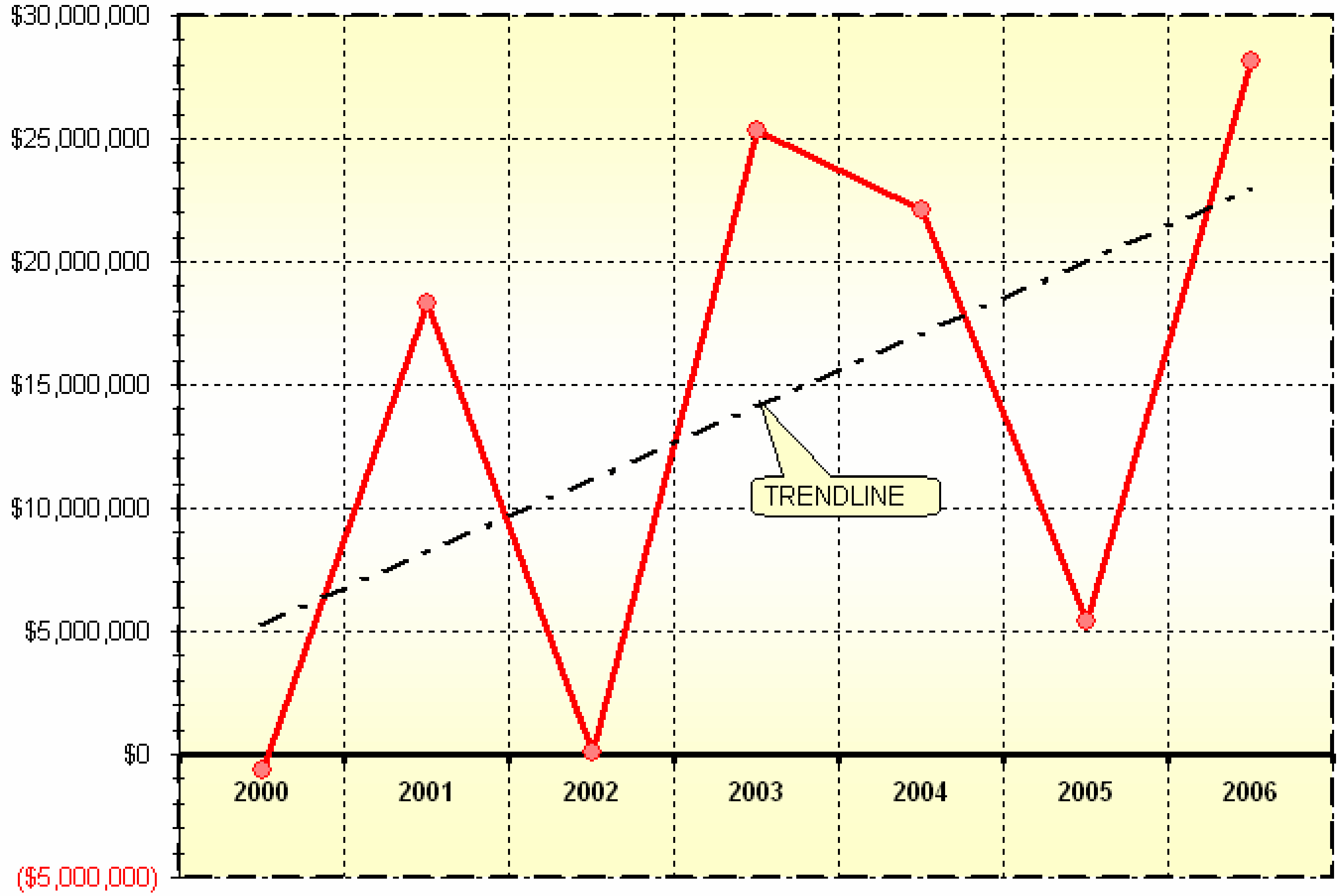
Attachments

1. Investment Assets vs Actuarial Liabilities
2. Salary Increases Greater Than Projected



	6/30/2000	6/30/2001	6/30/2002	6/30/2003	6/30/2004	6/30/2005	6/30/2006
1 Actuarial value of assets	2,009,293	2,119,000	2,128,000	2,057,000	2,071,000	2,216,000	2,430,000
7 Actuarial Liability	1,641,000	1,777,000	1,919,000	2,202,000	2,395,000	2,585,000	2,912,000

SALARY INCREASES GREATER THAN PROJECTED (Dollars)



	6/30/2000	6/30/2001	6/30/2002	6/30/2003	6/30/2004	6/30/2005	6/30/2006
Salary Increase Exceeds Budgeted	(644,000)	18,300,000	116,000	25,288,000	22,121,000	5,431,000	28,116,000