

# AGENDA ITEM

**JULY 145**

CalPERS for Retiree Healthcare Trust -  
Authorization to Contract for State Bar of  
California Post Employment Retirement  
Welfare Benefit Trust

**Date:** June 26, 2008

**To:** Members of the Board Committee on Planning, Program Development and Budget  
Members of the Board of Governors

**From:** Peggy Van Horn, Chief Financial Officer

**Subject:** CalPERS for Retiree Healthcare Trust - Authorization to Contract for State Bar of  
California Post Employment Retirement Welfare Benefit Trust

## **Executive Summary**

The State Bar of California offers post retirement health and vision benefits to executive staff employees who have met certain criteria established in the Rules and Regulations Relating to the Employment of Executive Staff. In order to better manage and control the cost of this retirement benefit, staff has been working on creating a trust agreement that will account for the funding of the retiree healthcare obligation by utilizing higher yield investment options than those allowed for use in investing general government funds.

As staff was working on creating a trust, the Governor signed Assembly Bill 554 into law. Prior to the enactment of this law, only public employers who contracted for health benefits through CalPERS could utilize the CalPERS-run trust for retiree healthcare, the California Employers' Retiree Benefit Trust ("CERBT"). Effective January 1, 2008, all California public employers can join the CERBT to pre-fund post retirement benefit obligations. Staff and an outside investment consultant, Milliman, recommend using the CalPERS CERBT because CalPERS offers several advantages over other providers, as discussed in greater detail in this item and in the attached report from Milliman. (Attachment 1.) CalPERS requires that the Board adopt the CalPERS Agreement and Election to Prefund Other Post Employment Benefits at a public meeting. (Attachment 2.)

Milliman recommended the CalPERS trust as the clear choice, and the Investment Subcommittee of the Planning Committee vetted with Milliman the CalPERS option and the options provided by other public agency service providers. The Investment Subcommittee unanimously approved recommending CalPERS to the Planning Committee and the Board.

## **BACKGROUND**

The State Bar's Rules and Regulations Pertaining to the Employment of Executive Staff Employees provide for a health and vision post retirement benefit, (also known as an OPEB or "Other Post Employment Benefit). In order to receive the benefit, an executive employee must have met all the criteria established in the benefit plan document.

At present, the State Bar accrues the annual OPEB cost based upon current actuarial assumptions, reports the expense in the State Bar's General Fund, and invests the monies in accordance with the State of California's requirements for the investing of governmental funds. However, Statement no. 45 of the Governmental Accounting Standards Board (GASB 45),

which recently took effect, establishes new standards for measurement, recognition, and disclosure of OPEB expenses/expenditures, related liabilities, note disclosures, and supplementary information included in financial reports of state and local government employers. Under GASB 45, the State Bar must report the Unfunded Actuarial Accrued Liability (UAAL) and Net OPEB Obligations on its financial statements, as follows:

Unfunded Actuarial Accrued Liability (UAAL) - the UAAL must be disclosed in the notes of the State Bar's financial statements. The UAAL represents the excess of the actuarial accrued liability over the actuarial value of assets set aside in a qualifying instrument (e.g., a 115 trust) to fund the OPEBs. The actuarial accrued liability is the present value of future OPEBs that have already been earned by covered individuals under the Bar's OPEB plan. Thus, the UAAL indicates the extent to which OPEBs are unfunded on an actuarial basis.

Net OPEB Obligation - the Net OPEB Obligation must be reported on the State Bar's balance sheet as a liability or asset. Generally, GASB 45 requires that, each year, an actuary calculate the amount the Bar needs to contribute for OPEBs in order to ensure that the Bar has adequate resources in the future to pay the promised benefits. GASB 45 refers to this amount as the "annual required contribution" ("ARC") (a misnomer, since no contribution is actually required by GASB 45). The Net OPEB Obligation is the cumulative difference between the State Bar's annual OPEB cost (essentially, the ARC) and the State Bar contributions that meet the requirements discussed below.

Only State Bar contributions that meet the following requirements may counted for purposes of calculating the Net OPEB Obligation: (1) the contributions are made to fund current OPEB payments (i.e., contributions made directly to or on behalf of retirees or beneficiaries and any premium payments made to an insurer); or (2) the contributions are made to fund future OPEBs, but only if (i) the contributions are irrevocably transferred to a trust or equivalent arrangement; (ii) assets under the trust are dedicated to providing OPEBs to retirees and their beneficiaries; and (iii) the trust assets are legally protected from the employer's or plan administrator's creditors.

State Bar general funds are restricted to certain investments listed in California Government Code 53601. However, section 53620 of the California Government Code provides an exemption to section 53601 for "funds designated for payment of employee retiree health benefits . . ." Under section 53620, "the governing body of a local agency may invest [such funds] in any form or type of investment deemed prudent by the governing body . . ." Therefore, if we create a trust to pay for the State Bar's OPEB obligations, these segregated funds can be invested in a diversified, long-term investment portfolio. These code sections explicitly provide the investment discretion necessary to optimize long-term returns while appropriately reflecting risk, liquidity and other objectives. Having higher earnings will help reduce the State Bar's OPEB liabilities and therefore also what liabilities the State Bar is required to report on its financial statement under GASB 45.

## **DISCUSSION**

It is recognized that there is a fiduciary responsibility to invest OPEB funds in a prudent manner, similar to a defined benefit plan where the goal is to minimize risk while maximizing return. If the program does not have a qualified internal investment staff, it is important to select a provider that has investment options or an investment program that is consistent with that responsibility.

Milliman looked at four of the top providers of similar services to public agencies. All of the providers profiled offer qualified services, however costs of providing services vary, depending upon the level of customization and support required. Staff cannot find any justification, at least at this time, for creating a customized program or paying the higher costs associated with establishing an individual trust.

### Advantages of CalPERS

As discussed in the report, Milliman found that the California Employers' Retiree Benefit Trust (CERBT) sponsored by CalPERS offers several advantages that the other providers cannot offer. As the sponsor of one of the world's largest public pension plans, there is an extremely high level of scrutiny of all of CalPERS investment and benefit programs, including the CERBT, which is managed by the CalPERS Investment Office. There are also additional levels of risk management and review of the investment program, including a dedicated risk management group, the use of an external investment consultant, as well as the CalPERS Board of Trustees.

From an investment standpoint, the CalPERS Public Employees' Retirement Fund (PERF) would serve as the investment vehicle. The Milliman report finds the internal investment staff at CalPERS to be among the best in the profession. The report notes that external third-party investment consultants review the investments and report directly to the Board of Trustees, which provides an additional level of oversight that is built into the CERBT. Further, from an administrative standpoint, the CalPERS Board of Trustees provides a Board level review of the program and its selection of investment managers. The CERBT program also provides an investment policy and has established draft copies of all of the required documentation, including detailed information regarding their requirements for joining the program.

### Other Considerations

The Milliman report points out that CalPERS has not obtained a private ruling letter from the IRS, nor do they intend to do so. CalPERS determined that a private ruling letter was not necessary due to the simple and straightforward design of the CERBT, and its rigorous process of defining the documentation and procedures that employers are required to follow in order to participate in the trust. It feels that a private ruling letter from the IRS would not protect participants from a poorly administered trust, once it is established, therefore they have taken great pains to structure and administer the CERBT to be in compliance with IRS regulations. While many private sector trust providers tout having a private ruling letter, CalPERS staff pointed out that it does not provide a blanket guarantee, and may serve more as a marketing tool.

It should also be noted that there is a minimum three-year commitment to the program. However, Milliman advises that this does not create a disadvantage at this point in time, based upon the current state of the OPEB funding marketplace. In addition, any State Bar funds in the CERBT would always be available to pay the State Bar's OPEBs as they become due. Thus, if the State Bar wishes to cease participating in the CERBT, we could simply cease making contributions and spend down our CERBT funds for OPEBs until the funds are exhausted.

### Conclusion

Milliman recommended the CalPERS trust as the clear choice, and the Investment Subcommittee of the Planning Committee vetted with Milliman the CalPERS option and the other providers. The Investment Subcommittee unanimously approved recommending

CalPERS to the Planning Committee and the Board. Staff agrees with Millimans's recommendation to review the program on a regular basis (at least annually), and reassess whether the State Bar of California's OPEB funding obligations are being met by this program.

**FISCAL IMPACT**

Based on preliminary information provided to us by our actuary, a rise in investment income from the current average return for fixed income investments of 4% to a higher return of 7.75% is expected to reduce the Bar's expenditures by \$12 million over a 30-year period.

**BOARD BOOK/ADMINISTRATIVE MANUAL**

This item has no impact on the Board Book/Administrative manual.

**RECOMMENDATION**

Staff recommends that the Board adopt the CalPERS Agreement and Election to Prefund Other Post Employment Benefits. Staff further recommends that the Board authorize the Executive Director, or her designee, to take all other acts necessary to begin putting OPEB funds into the CalPERS trust. Staff also agrees with Milliman's recommendation to review the program on a regular basis (at least annually), including reassessing whether this program is meeting the State Bar of California's OPEB funding obligations.

**COMMITTEE RESOLUTION**

If the Board Committee on Planning, Program Development and Budget concurs with the Investment Subcommittee's recommendations, the following resolutions are suggested:

**RESOLVED** that the Board Committee on Planning, Program Development and Budget recommends that the Board of Governors adopt the CalPERS Agreement and Election to Prefund Other Post Employment Benefits, and it is

**FURTHER RESOLVED** that the Board Committee on Planning, Program Development and Budget recommends that the Board of Governors authorize the Executive Director, or her designee, to take all other acts necessary to begin putting OPEB funds into the CalPERS trust. If the Board agrees with the recommendations of the Board Committee on Planning, Program Development and Budget, the following resolutions are suggested:

**BOARD RESOLUTION**

**RESOLVED** upon recommendation of the Board Committee on Planning, Program Development and Budget, the Board of Governors hereby adopts the CalPERS Agreement and Election to Prefund Other Post Employment Benefits, and it is

**FURTHER RESOLVED** upon recommendation of the Board Committee on Planning, Program Development and Budget, the Board of Governors hereby authorizes the Executive Director, or her designee, to take all other acts necessary to begin putting OPEB funds into the CalPERS trust.