

AGENDA ITEM E

702 MARCH 2016

DATE: March 7, 2016

TO: Members, Board of Trustees

FROM: Leah Wilson, Chief Operating Officer
Christine Wong, Finance Director

SUBJECT: Reserve Policy

BACKGROUND

At its February 1, 2016, meeting, the Board of Trustees adopted a Reserve Policy. That Policy, which is provided as Attachment A, reflects a two-month, or 17 percent, Minimum Target Reserve level and a 30 percent reserve ceiling, identifies circumstances under which reserves may be reduced below the minimum reserve target level, and sets parameters for spending reserve balances in excess of the reserve ceiling.

At the time of initial adoption, the Board reviewed application of the Reserve Policy on General, Restricted, and Special Funds with the impact of Governmental Accounting Standard Board Statement (GASB) 68 in mind. Under GASB 68, public employers that participate in a defined benefit pension plan administered as a trust or equivalent arrangement are required to record the net pension liability, pension expense, and deferred outflows/deferred inflows of resources related to pensions in their financial statements as part of their financial position. Specifically, State Bar fund balances were reduced by the Bar's unfunded pension liability of approximately \$19 million, as identified in CalPERS' 2014 valuation report. Board action in March was anticipated specifically as related to restoration of General, Admissions, and Annual Meeting Fund reserve balances, which were below the minimum reserve target level, and spend-down of other Funds over the reserve ceiling.

Subsequent to the February meeting, the Bar received the 2015 CalPERS valuation report. This report reflects an increased unfunded pension liability of \$31.2 million. However, staff, after extensive consultation with external auditor Moss Adams and CalPERS, has determined that the \$31.2 million pension liability is appropriately classified as a long-term liability in the State Bar's financial statements, rather than as a *current* liability impacting budget development and Reserve Policy implementation. Staff discussed the possibility of establishing a separate Fund specifically designated as an unfunded pension liability reserve; while the Board may ultimately decide to do so, the Bar's strong pension position suggests that such a reserve may not be needed at this time. Even with the significant increase in unfunded liability, as of the 2015 valuation report, the Bar's pension is 90 percent funded.

Pursuant to the decision to remove the unfunded liability from the working capital analysis, General, Restricted and Special Fund balances have been restated, with only two Funds falling below the Minimum Target Level. Several funds now exceed the

reserve ceiling level. Current Working Capital and Reserve Level information is provided as Attachment B. Approaches for addressing both scenarios, as well as proposed modifications to the Reserve Policy itself, are outlined below.

DISCUSSION

Fund Balances Below Minimum Target Level

Two Funds, the Annual Meeting and Equal Access Funds, fall into this category. It is not recommended that the Board take action regarding either at this time.

With respect to the Annual Meeting Fund, there is no need for a Fund balance to be maintained. Under current budget practices, the Education Fund in the Office of Education will now cover any shortfall in the Annual Meeting Fund on an annual basis. Therefore, a minimum target reserve for this Fund is not necessary.

With respect to the Equal Access Fund, and as outlined separately below, staff recommends a modification to the Reserve Policy exempting all grant-related Funds from the minimum target reserve.

Fund Balances in Excess of Reserve Ceiling

Nine Funds have balances in excess of the 30 percent reserve ceiling, as follows:

Grants Fund

This is a grant-related Fund being recommended for exclusion from the excess reserve spend-down provisions of the Policy.

Sections Funds

The Sections Funds are excluded from the spend-down provisions of the Reserve Policy.

Legislative Activities Fund

This Fund was created by the Board after the passage of Business and Professions Code section 6140.05, which allowed members an opt-out if they did not want to support lobbying and related activities outside of Keller. While the statute precludes the Bar from spending funds in excess of the amount collected on lobbying or defense of any litigation challenging lobbying activities, it does not expressly restrict the way in which revenue generated can be spent. In creating the Fund however, the Board did limit allowable expenditures to lobbying-related activities.

The \$5 opt-out fee generates approximately \$700,000 in annual revenue. Annual operating costs have averaged between \$550,000 and \$600,000 over the last several years. These costs primarily reflect direct charges for 2 State Bar employees, and lobbyist contract charges. The excess Fund balance currently totals \$520,150.

Staff recommends that, for 2016, a comprehensive review of personnel costs associated with legislative activities be conducted, in order to ensure that all applicable expenses are being appropriately charged to the Fund. Specifically, the Executive Director, General Counsel, Chief Operating Officer, Chief Trial Counsel, and Managing Director, Communications, all spend a significant amount of time on work that ultimately ties to the Bar's overall lobbying efforts. Staff

anticipates that this effort will result in an additional \$100,000 being charged off to the Fund this year, and annually, thus “right-sizing” the revenue/expenditure equation going forward.

However, even after the personnel cost adjustments are made, a sizeable Fund balance will remain. Staff recommends that the Board modify the Fund definition to allow for a spend-down of the estimated \$420,000 in remaining excess reserves, in accordance with the criteria outlined in Section E. of the Reserve Policy. Staff specifically recommends that the Board reduce 2017 dues for those attorneys who paid the \$5 fee in 2016, in an amount equal to the remaining excess reserve balance. In the alternative, the Board may choose to redirect this funding to the Client Security Fund. Redirection of \$420,000 would result in an estimated additional 100 applicants being paid out this year.

Elimination of Bias & Bar Relations Fund

This Fund was created in response to the *Brosterhous* decision, which narrowed the test for chargeability established by the United States Supreme Court in *Keller*, to require that a chargeable activity must have a simple, direct connection to either the regulatory functions of the Bar, or the services that an attorney provides to his or her client.

The \$5 opt-out Elimination of Bias & Bar Relations fee generates slightly under \$800,000 in annual revenue, while the two programs together incur annual expenditures in excess of \$1,000,000. Thus, the Fund operates at an annual deficit of \$200,000 based on 2015 operating results and forward looking trends. Current excess reserves total \$236,147.

With respect to these excess reserves, the Board is asked to authorize staff to partner with the Council on Access and Fairness (COAF) to identify an appropriate entity to advance a bar passage initiative and/or the 2015 recommendations of the State Bar’s Mentoring Taskforce. These entities include the California Bar Foundation and CaliforniaLAW (an entity supporting pipeline and pathways efforts operating under the auspices of the Foundation for California Community Colleges, a 501(c)(3) serving as the fiscal agent for CaliforniaLAW). An amount not to exceed one-half of the available Fund balance should be set aside to implement the approach identified through this process.

Staff recommends that the remaining Fund balance be excluded from the spend-down requirement given the structural deficit in the Fund. Staff will develop and implement a plan for reducing Fund expenditures on an ongoing basis, so that they do not exceed annual revenue, beginning in 2017.

Lawyer Assistance Program

Business and Professions Code section 6140.9 provides that the Lawyer Assistance Program (LAP) be supported in whole or in part by a fee of \$10 per active member, and a fee of \$5 per inactive member, but also states that excess funds may be applied to the cost of State Bar General Fund programs.

The \$10 mandatory LAP fee generates approximately \$2 million in annual revenue, with operating expenses significantly below that amount. The current excess reserve balance is \$1,747,480. Staff recommends that \$1.6 million of this reserve be redirected to the Client Security Fund for 2016 payouts. With this infusion of resources, CSF estimates that it can pay out an additional 375 applications this year. Staff recommends that the balance of the reserve be spent to invest in program evaluation and potential redesign, in light of the passage of time since the program’s inception, the changing composition of the program’s clientele (which now

includes a significant number of pre-admits), current trends in substance abuse and mental health assessment and case management, and the recently released American Society of Addiction Medication study¹ which identified significant substance abuse and mental health needs among attorneys, particularly young practitioners.

Legal Specialization Fund

California Rule of Court rule 9.35 authorizes the State Bar to set and collect appropriate fees for the Legal Specialization program. Those fees include certification examination fees of \$350-\$750, and annual fees ranging from \$350-\$360. Annual revenues are approximately \$2.5 million, with expenses substantially less, at slightly over \$1.3 million. The Fund has a sizeable balance, with \$4.99 million in excess reserves. The California Board of Legal Specialization met on March 4, 2016, to develop reserve spend-down recommendations for Board consideration, as well as a long-term approach to addressing the structural imbalance between Fund revenue and expenditure levels. These recommendations will be presented orally to the Board at its March 11 meeting.

Modifications to the Reserve Policy

Under the current Policy, Sections Funds are explicitly excluded from excess reserve spend-down requirements. Staff recommends that the Board modify the Policy to allow additional exclusions as follows:

Minimum Target Reserve and Excess Reserve Spend Down Exclusions. Staff recommends that all grant-related Funds, specifically the Grants, Legal Services Trust, Equal Access, Justice Gap, and Bank Settlement Funds, be excluded from minimum target and excess spend down requirements. These Fund balances will routinely rise and fall above and below targeted levels based on the cyclical nature of significant inflows and outflows; further, the \$44 million in new grant funding received will warrant a measured distribution approach, one likely to occur over several years, resulting in a healthy Fund balance being maintained for some time.

In addition, staff recommends that the Policy be modified to reflect a newly created Bank Settlement Fund; \$44 million in bank settlement money will be deposited into this Fund.

A revised Reserve Policy reflecting these modifications is provided as Attachment C.

RECOMMENDATION

Staff recommends that the Board:

1. Direct staff to identify all personnel expenses related to the purposes of the Legislative Activities Fund and to charge the Fund for said expenses on an annual basis.
2. Determine if excess reserves remaining in the Legislative Activities Fund after all appropriate personnel expenses are incurred should be used for member reimbursement or redirected to the Client Security Fund.
3. Modify the definition of the Legislative Activities Fund as follows (italicized added):

¹ *The Prevalence of Substance Use and Other Mental Health Concerns Among American Attorneys*, Patrick R. Krill, JD, LLM, Ryan Johnson, MA, and Linda Albert, MSSW, 2016.

Accounts for the consideration of measures that are deemed outside of the parameters established in Keller vs. the State Bar, the purview determination and any litigation in support or defense of that lobbying. *In addition, can be used for Client Security Fund payments.* Such activities are funded by members electing to support these activities. This fee of \$5 is part of the membership fees; however, members have the option to not remit this fee.

4. Direct staff to partner with COAF to identify an appropriate entity to advance a bar passage initiative and/or the 2015 recommendations of the State Bar's Mentoring Taskforce in an amount not to exceed one-half of the Elimination of Bias & Bar Relations Fund excess fund balance, and to report back to the Board on the status of that effort no later than the October, 2016, Board of Trustee meeting.
5. Direct staff to develop and implement a plan for addressing the structural deficit in the Elimination of Bias & Bar Relations Fund to be reflected in the 2017-2019 budget.
6. Redirect excess Lawyer Assistance Program reserves totaling \$1.6 million to the Client Security Fund to increase 2016 payouts.
7. Direct staff to invest the remaining excess reserves in the Lawyer Assistance Program Fund in investments in program evaluation and redesign.
8. Address recommendations submitted by the California Board of Legal Specialization as related to the Legal Specialization Fund excess reserve balance of nearly \$5 million.
9. Adopt modifications to the Reserve Policy as reflected in Attachment C.

FISCAL / PERSONNEL IMPACT:

As outlined above.

RULE AMENDMENTS:

None

BOARD BOOK IMPACT:

Tab 17, Article 1, section 3

PROPOSED BOARD OF TRUSTEES RESOLUTION:

RESOLVED, that the Board of Trustees adopts and directs staff to implement each of the recommendations listed above; and it is

FURTHER RESOLVED, that the Board of Trustees adopts modifications to the Reserve Policy as outlined in Attachment C; and it is

FURTHER RESOLVED that the Board of Trustees adopts the following modified description of the Legislative Activities Fund.

Accounts for the consideration of measures that are deemed outside of the parameters established in Keller vs. the State Bar, the purview determination and any litigation in support or defense of that lobbying. In addition, can be used for Client Security Fund payments. Such activities are funded by members electing to support these activities. This fee of \$5 is part of the membership fees; however, members have the option to not remit this fee.