COUNTY OF LAKE

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Legislation Details (With Text)

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Title: Consideration of (a) Resolution adopting the Post-Employment Benefits Trust Administered by Public Agency Retirement Services (PARS) and Appointing the County Administrative Officer as the Plan Administrator; and (b) Resolution Transferring the Current Balance in the Pension Stabilization Reserve (Fund 155) to the Section 115 Post-Employment Benefits Trust and Authorizing Initial Investment Portfolio Option

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Attachments: 1. Attachment A_Summary of Benefits, 2. Attachment B_Investment Performance, 3. Resolution_Approve PARS, 4. Resolution_Transfer fund 155

Date	Ver.	Action By	Action	Result
6/26/2018	1	BOARD OF SUPERVISORS	Adopted	

MEMORANDUM

TO: Board of Supervisors

FROM: Carol J. Huchingson, County Administrative Officer

DATE: June 26, 2018

SUBJECT: Consideration of (a) Resolution adopting the Post-Employment Benefits Trust Administered by Public Agency Retirement Services (PARS) and Appointing the County Administrative Officer as the Plan Administrator; and (b) Resolution Transferring the Current Balance in the Pension Stabilization Reserve (Fund 155) to the Section 115 Post-Employment Benefits Trust and Authorizing Initial Investment Portfolio Option

EXECUTIVE SUMMARY:

Scope of the Issue. Your Board has previously been apprised of escalating pension costs and the challenge of ensuring that pensions are sufficiently funded. The County pension plans managed by California Public Employees Retirement System (CalPERS) consist of the "Miscellaneous Plan", which covers approximately 82% of County employees, and the "Safety Plan" with approximately 18% of employees.

Funding of CalPERS pensions relies on three sources: a) employee contributions, which are in an amount fixed by law; b) investment returns, which vary according to financial market performance; and 3) employer contributions, which are increased or decreased in accordance with the performance of the other two funding sources in order to meet the expected funding need. Although CalPERS dictates the annual required employer contribution, the fact is, their required contribution levels have been insufficient to meet the actuarially determined funding requirements. CalPERS indicates that the primary reason for this shortfall is their underperforming investment returns which CalPERS relies upon for over 60% of pension funding. Consequently, the accumulated pension assets are only 70% of the amount needed to the pay what the County is likely to owe current and retired staff. This 30% shortfall in funding is commonly known as the unfunded accrued pension liability.

It is in the County's interest to reduce the amount of unfunded accrued pension liability for two reasons: 1) to improve the County's financial statements which are now required to reflect pension liabilities, and 2) a reduction in pension liability results in reduced pension payments which in turn frees-up funding for other public services.

How to Address the Issue. Until CalPERS generates sufficient investment returns to address the unfunded pension liability, the most fiscally advantageous option to address the issue is to pre-fund pension obligations. In fact, pre-funding is the most common approach taken by public agencies in the State. The most common method of pre-funding pension obligations is to set funds aside in an irrevocable trust which is commonly known as "Section 115" Trust, based on the enabling provision of the Internal Revenue Code.

A primary advantage of placing funds into the Trust rather than holding them in a County reserve fund is that investments in the Trust can be made under the more flexible rules of California Government Code Section 53216.1 rather than the more restrictive rules of Government Code Section 53601. An investment in a well-managed trust account has the potential of yielding a much higher rate of return than those funds held in the County's treasury investment pool or funds held by CalPERS.

The other notable advantage of holding funds in trust rather than contributing an equivalent amount directly to CalPERS is that the County retains complete control over the timing and amount of disbursements from a trust. The County also controls the timing of contributions to the Trust.
The combination of the aforementioned features potentially allows the County to stabilize rates or "smooth" out contributions to CalPERS - contributing to the Trust when the County has funds available and then using the Trust to pay CalPERS when the County's revenues decline. Smoothing equates to dampening year-to-year contribution fluctuations by offsetting investment gains/losses from a particular year by utilizing investment gains/losses from a previous year. A final advantage of the Trust approach is that assets held in the Trust would directly reduce the County's pension liability for financial reporting purposes. The anticipated goal is that over-time the net liability will be further reduced by the resources available in the County's Section 115 Trust.
A more detailed list of all the benefits of participating in a Section 115 Trust are summarized on Attachment A but in summary, the Trust will improve the management and diversity of pension related

investments.
In addition to addressing unfunded pension liability, a Section 115 Trust can be used to address the County’s liability for other post-employment benefits (OPEB), consisting of the County’s required contribution to the cost of health insurance coverage for retirees.

Which Section 115 Trust to Use. In California, there are only-two IRS qualified independent retirement plan administrators that offer Section 115 trusts for pensions - Public Agency Retirement Services (PARS) and Public Financial Management Group (PFM). Staff is recommending PARS because, unlike PFM, their primary business is administering 115 trusts; they have the highest participation of other California cities and counties; and their program allows for risk diversification and investment objectives to meet the unique needs of public agencies. PFM also has a Private Letter Ruling, but is less focused on administering trusts, has fewer plans under administration, and is not structured as well to meet the County's investment and risk targets.

The PARS Approach. PARS has partnered with US Bank to serve as trustee and Highmark Capital Management Inc. to provide investment advisory services. Highmark provides five standard investment portfolios, each reflecting a different asset allocation that accommodate varying levels of risk exposure (Conservative, Moderately Conservative, Moderate, Balanced, and Capital Appreciation). The investment performance of each portfolio as well as CalPERS performance, are summarized on Attachment B.

Subsequent to today’s action, a County Investment Advisory Committee will be formed which will work with Highmark to develop investment guidelines for your Board’s consideration at a later date. These guidelines will recommend a maximum level of risk tolerance, investment limitations and performance standards that will collectively govern the selection of acceptable portfolio options. Until those guidelines are formulated, staff is recommending that any funds deposited in the Trust be invested in the “Moderate” portfolio as it is the most common choice made by other participating public agencies and consists of a mix of equity, fixed income and cash investments.

Structure and Funding of the Trust. The initial funding transferred from the Pension Stabilization Reserve to the Trust, as authorized by the attached resolution, will be used solely to support pension obligations incurred by employees in the General Fund since all the funding currently in the Pension Stabilization Reserve was provided by general fund dollars. This initial funding will be deposited equally into two subaccounts within the Trust, one to support the General Fund’s CalPERS Miscellaneous Plan obligations and one to support the General Fund’s CalPERS Safety Plan obligations.

In order to facilitate prefunding of the pension liability incurred by non-General Fund departments, two additional subaccounts will be established to support non-General Fund Miscellaneous Plan and non-General Fund Safety Plan obligations. In order to fund these non-General Fund subaccounts as well as future deposits to the General Fund subaccounts, staff is evaluating an approach whereby each department (both General Fund and non-General Fund) be required to make an additional PERS contribution (surcharge) on behalf of each Misc. employee. The contribution would likely range from .25 percent to 2 percent of salary expense and would also be deposited in the applicable subaccount within the Section 115 Trust. At this time, however, more research is needed and additional options need to be explored.

Today representatives from PARS will provide additional information to you Board about irrevocable trusts for both OPEB and pensions.

FISCAL IMPACT: __ None _X_Budgeted __Non-Budgeted
Estimated Cost: None
Amount Budgeted: None
Additional Requested: None
Annual Cost (if planned for future years): None

FISCAL IMPACT (Narrative): Adoption of a Section 115 Trust and subsequent contributions thereto will help the County address its long-term CalPERS unfunded pension liability. Subsequent contributions can be funded in several ways including annually earmarking a portion of one-time monies from fund balance carryover (General Fund) and/or charging departmental budgets an additional surcharge. Whatever option is utilized will impact the amount of funding remaining available for other needs.

STAFFING IMPACT (if applicable): None

RECOMMENDED ACTION:

It is recommended that you're Board take the following actions:

1. Approve Resolution Adopting the Post-Employment Benefits Trust Administered By Public Agency Retirement Services (PARS) and Appointing the County Administrative Officer as the Plan Administrator.
2. Approve Resolution Transferring the Current balance in the Pension Stabilization Reserve (Fund 155) to the Section 115 Post-Employment Benefits Trust and Authorizing Investment Portfolio Option.

ATTACHMENTS:

- Attachment A - Summary of Section 115 Trust Benefits
- Attachment B - Investment Performance of Various Portfolio Options.