



January 31, 2017

Santa Clara County Civil Grand Jury  
Superior Court  
Attention: Tamara Davis, Deputy Manager of Jury Services  
191 North First Street  
San Jose, California 95113

RECEIVED  
FEB 06 2017  
CIVIL GRAND JURY

Re: 2016-2017 Santa Clara County Civil Grand Jury – Follow Up Report on “An Analysis of Pension and Other Post Employment Benefits”

Dear Ms. Davis;

The Town continues to search for ways to mitigate the growing cost of pension and OPEB liabilities. Since 2011-2012, the Town contributed \$1.7 million into the OPEB irrevocable trust and designated \$500,000 as pension reserve. In the coming year, the Town will be researching in either establishing a trust for pension liability or to pay down a portion of the pension liability directly with CalPERS. As of June 30, 2015, the Town’s OPEB liability is 46 percent funded resulting in an \$871,000 unfunded liability. For Pension, the Town total unfunded pension liability is \$2.4 million based on the June 30, 2015 CalPERS valuation report.

Below are responses to recommendations provided in “An Analysis of Pension and Other Post Employment Benefits” report.

**Recommendation 1:** The Cities should adopt pension plans to extend the retirement age beyond current retirement plan ages.

**2011-2012 Response:** The recommendation has been implemented. The Town of Los Altos Hills has created a second tier to its retirement plan which increased the retirement age for new employees from 55 to 60. We acknowledge that this is still five years earlier than most private sector employees, but is the oldest age eligible allowed under CalPERS’ current plans.

**2016-2017 Response:** The Town’s current pension plan includes Tier 2, with retirement age at 60 and Tier 3, with retirement age at 62. Tier 3 is the PEPRA tier established by CalPERS in accordance with State pension regulation. The State pension regulation also closed Tier 1 and Tier 2 from entry by non-CalPERS members.

**Recommendation 2A:** Santa Clara County and the cities of Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga and Sunnyvale should work to implement second tier plans.

**2011-2012 Response:** Not applicable

**2016-2017 Response:** Not applicable

**Recommendation 2B:** For Gilroy, Los Gatos, Milpitas and Palo Alto, which has not implemented second tier plan for MISC and Public Safety second tier plans should be implemented for both plans.

**2011-2012 Response:** Not applicable

**2016-2017 Response:** Not applicable

**Recommendation 2C:** All Cities' new tier of plans should close the unfunded liability burden they have pushed to future generations. The new tier should include raising the retirement age, increasing employee contributions, and adopting pension plan caps that ensure pensions do not exceed salary at retirement

**2011-2012 Response:** The recommendation has been implemented for two of the three specific suggestions included in Recommendation 2C. As noted earlier, the Town adopted a "second tier" to its retirement plan in 2011. With the change made as part of implementation of the "second tier," the Town increase the retirement age 5 years from 55 to 60 and required all employees in this tier to pay 7% of eligible salary to their accounts. Both of these changes are options allowed by CalPERS. The third recommendation to adopt a cap will not be implemented because it is our understanding that the Town has no authority to cap the pension according to the provisions of the contractual agreement with CalPERS. However, practically speaking, exceeding the final year's salary would be highly unlikely given that the Town's plan is a 2% plan and utilizes the average of the last three years' pay to calculate the benefit. A new employee would have to work more than 40 years and exceed 63 years of age to receive more than 100% of their salary at retirement.

**2016-2017 Response:** As a member of CalPERS, the Town is required to continue to pay for unfunded liability for current and retired employees. The State Pension Reform of 2013 has made CalPERS create a new PEPR tier where employees are contributing 50% of normal cost and placed a maximum salary cap for the pension benefit calculation. However, based on CalPERS operation, whenever the actuary assumptions, such as discount rates and mortality rate, changes, the unfunded liability will change.

**Recommendation 3:** The Cities should adopt policies that do not permit Benefit enhancements unless sufficient monies are deposited, such as in an irrevocable trust, concurrent with enacting the enhancement, to prevent an increase in unfunded liability

**2011-2012 Response:** The recommendation has not yet been implemented, but the Town intends to adopt such a policy in fiscal year 2012-13.

**2016-2017 Response:** The Town did not adopt said policy in 2012-13. The City Council and Finance and Investment Committee are risk adverse and would not approve benefit enhancement which would generate potential future costs for the Town. Therefore, such policy was not necessary.

**Recommendation 4A:** The Cities should require all employees to pay the maximum employee contribution rate of a given plan

**2011-2012 Response:** The Town partially agrees with the recommendation as it applies to pensions and, as noted above, implemented it for new (Tier 2) employees last year. While the Town's current policy is to continue to pay both the employer and employee pension contribution for Tier 1 employees, Tire 2 employees do pay the CalPERS employee rate of 7%. The Town anticipates that the

State of California may require the employees pay their share as part of the governor's pension reform. Should the governor's reform efforts fail, Town management will re-evaluate the employee pension contribution for Tier 1 employees next year.

In regards to OPEB benefits, five years ago, the Town effectively created a second Tier for this benefit as well and amended its retiree medical plan to limit the benefit for all qualified annuitants hired after October 11, 2007 to the PEMCHA minimum. In 2012, the Town implemented a cafeteria plan which limited the medical benefit for active and qualified annuitants to the Kaiser plan premium rate. In 2013, the Town will implement a revised cafeteria plan which passes part of the increase in premium cost for dependent care on to the employee and/or the qualified annuitant.

**2016-2017 Response:** All Tier 2 and Tier 3 employees are contributing the maximum employee contribution rate. For Tier 1 employees, the Town is reducing its contribution one percent per year and Tier 1 employees will contribute the maximum employee contribution rate by 2019-20. As for medical coverage, the Town uses a cafeteria plan for health care cost and the maximum contribution is based on Kaiser rates. Additionally, the Town's contribution no more than 90 percent of the Kaiser's dependent portion.

**Recommendation 4B:** The Cities should require employees to pay some portion of the Past Service Cost associated with the unfunded liability, in proportion to the Benefits being offered.

**2011-2012 Response:** The Town has not separately distinguished Past Service Cost from Normal costs, per se. However through the reaction of a second tier for our Pension benefit plan, the Town believes that it has followed the Grand Jury recommendation by requiring employees of the second tier to pay 7% of eligible salary toward the cost of the benefit. This is the maximum allowed by CalPERS.

For retiree medical benefits effective October 12, 2007, we have sharply reduced the benefit for new employees to the PEMHCA minimum and required annuitants who are or will receive the previous benefit package to pay a larger portion of the costs. At the time these changes were made, the Town believed that requiring any further contribution from current employees or annuitants would be too burdensome on a group that has not planned on these increased costs. However, in order to reduce the unfunded liability associated with this benefit, the Town has contributed significantly more than the actuarially required contribution (ARC) for each of the past several years and plans to continue to do so.

**2016-2017 Response:** The Town is part of the CalPERS Miscellaneous Pool and CalPERS has separated unfunded liability from normal cost. Both are currently paid by the Town and employees are only paying the member contribution portion.

**Recommendation 5:** The Cities, should immediately work toward implementing policy changes and adopting measures aimed at making full OPEB ARC payments as soon as possible.

**2011-2012 Response:** The recommendation has been implemented. As noted above, the Town has amended its plan to limit annuitant medical benefits for employees hired after October 11, 2007 to the PEMHCA minimum. In addition, the Town has done an actuarial evaluation of its OPEB plan and for each of the last two fiscal year has contributed more than the ARC in attempt to reduce the unfunded liability and stabilize future payments.

**2016-2017 Response:** The Town continues to contribute full OPEB ARC payments and pays out of pocket for current retiree medical benefits, even though the Town may elect to only offset the ARC contribution payment by retiree medical cost. This is the reason the Town's OPEB trust is 46% of total liability. In the next five year, the Town may be at risk of over-funding the OPEB trust and will begin researching on appropriate funding level.

**Recommendation 6:** The City of San Jose should eliminate the SRBR program or amend the SRBR program to prevent withdrawal of pension trust money whenever the pension-funded ratio is less than 100%.

**2011-2012 Response:** Not applicable

**2016-2017 Response:** Not applicable

**Recommendation 7:** The Cities should transition from defined benefit plans to defined contribution plans as the new tier plans are implemented.

**2011-2012 Response:** The recommendation has not yet been implemented, and we agree that most governments may need to "transition" away from defined benefit plans. But rather than a defined contribution plan, we believe that, in the near term, a more realistic and maybe even politically possible objective would be some sort of hybrid plan. The hybrid plan would continue a much more modest defined benefit plan that could provide a relatively safe and secure base retirement income, but would then supplement that plan with a defined contribution plan and/or Social Security. In addition, this new defined contribution plan, which could contain an employer match, would encourage younger employees to save for their retirement, give them a transferable asset while recognizing the risks inherent in retirement planning. Should the Governor be successful in his efforts to have the State adopt a "hybrid" risk sharing pension plan for the new hires, the Town would certainly evaluate this option.

**2016-2017 Response:** According to CalPERS, in order for the Town to transition to defined contribution plans, the Town must terminate our agreement with CalPERS. The cost to terminate with CalPERS currently stands at \$10 million. Additionally, CalPERS has ruled that the hybrid pension plan, where new hires are placed in the defined contribution plan, is not a viable plan. As such, Agencies cannot offer such benefit options without violating CalPERS pension regulations.

Sincerely,



Carl Cahill  
City Manager