

**SUBMITTAL TO THE BOARD OF SUPERVISORS
COUNTY OF RIVERSIDE, STATE OF CALIFORNIA**

186



FROM: Paul McDonnell, Treasurer-Tax Collector
Chairman, Pension Advisory Review Committee (PARC)

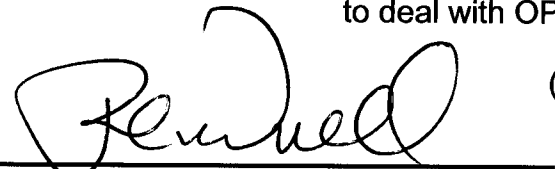
SUBMITTAL DATE:
May 26, 2006

SUBJECT: FY2005/06 Annual Report of the Pension Advisory Review Committee


RECOMMENDED MOTION: That the Board of Supervisors:

- (1) Receive and file the FY2005/06 PARC report;
- (2) Adopt the recommendation to use the balance in the Liability Management Fund to reduce the County's CalPERS liability and authorize staff to make the transfer of funds to CalPERS.
- (3) Designate the PARC as the clearinghouse for discussions of the financial aspects of Other Post Employment Benefits (OPEB) and direct the PARC to report back to the Board on a timely basis regarding financial strategies to deal with OPEB liabilities.

(Continued on page 2)



Paul McDonnell
Treasurer-Tax Collector, Chairman



Ron Komers
Asst CEO/ HR Director, Member



Bill Luna
County Finance Director, Member

FINANCIAL DATA	Current F.Y. Total Cost:	\$ 0	In Current Year Budget:	N/A
	Current F.Y. Net County Cost:	\$ 0	Budget Adjustment:	N/A
	Annual Net County Cost:	\$ 0	For Fiscal Year:	N/A

SOURCE OF FUNDS: 10000-1400100000	Positions To Be Deleted Per A-30	<input type="checkbox"/>
	Requires 4/5 Vote	<input type="checkbox"/>

C.E.O. RECOMMENDATION: **APPROVE**


County Executive Office Signature

Dep't Recomm.: Consent Policy
Per Exec. Ofc.: Consent Policy

Prev. Agn. Ref.: _____ **District:** _____ **Agenda Number:** **3.70**

Departmental Concurrence

BOARD OF SUPERVISORS

**Form 11: FY 2005/2006 Annual Report of the Pension Advisory Review
Committee**

May 26, 2006

Page 2

BACKGROUND: In October 2003, the Board of Supervisors approved the formation of PARC to develop a better understanding of the County's defined benefit pension plan. One of the responsibilities of PARC is to annually report to the Board on the performance of the plan, evaluate strategies to address under-funded and/or over-funded positions, and evaluate changes to the plan.

The Committee, with input from the County's independent actuary John Bartel, has prepared the following report for the Board. The report is the first annual report to be presented and follows three previous ad hoc reports. Previous reports presented the Board with a policy framework (Policy B-25), identified funding problems and presented funding solutions.

This report indicates favorable trends in funding status and contribution rate outlook. It also provides a recap of savings resulting from the prepayment financing and the refinancing of our prior CalPERS liability. Prepayment savings to the General Fund now total \$4.4 million and the issuance of Pension Obligation Bonds has resulted in \$38.5 million in savings to date.

While pension funding trends are positive, The Committee has identified OPEB liabilities as a major concern for County.

The Committee has recommended that the Board:

- (1) Receive and file the FY2005/06 PARC report.
- (2) Adopt the recommendation to use money in the Liability Management Fund to reduce the County's CalPERS liability and authorize staff to make the transfer of funds to CalPERS.
- (3) Designate the PARC as the clearinghouse for discussions of the financial aspects of Other Post Employment Benefits (OPEB) and direct the PARC to report back to the Board on a timely basis regarding financial strategies to deal with OPEB liabilities.

The Committee also reviewed and recommended the parameters of the annual prepayment. Those recommendations were incorporated in the Board's approval of the Annual Tax and Revenue Anticipation Notes (TRANS) on May 23, 2006.

Pension Advisory Review Committee



Annual Report

Riverside County
Pension Advisory Review Committee

June 6, 2006

Table of Contents

I	Executive Summary	1
II	Plan Funding Status	3
III	CalPERS Investment Performance	4
IV	Employer Rate Outlook	6
V	Pension Obligation Bond Update	8
VI	CalPERS Annual Prepayment.....	9
VII	Pension Reform	10
VIII	Other Post Employment Benefits (OPEB)	11
IX	Miscellaneous Issues	12
X	Recommendations	13

Appendices

1. Bartel Associates Report
2. New York Times Article, "Japanese Cars, American Retirees"
3. USA Today Article, "Retiree Benefits grow into 'monster' "

I Executive Summary

Introduction

The County's Pension Advisory Review Committee (PARC) was established in the fall of 2003 to develop an institutional framework to help guide policy decisions about retirement benefits. The following year, market losses for public and private pension funds brought the issue greater attention. Problems associated with a number of public agency's plans increased awareness, as the City of San Diego epitomized.

A key responsibility of the PARC is to produce an annual report. The report informs the Board and the public about important developments affecting county pension plans and provides information about projected costs and funding status.

This is the first annual report. Three previous reports presented between May 25, 2004 and February, 1, 2005 included status reports and addressed specific issues on an ad hoc basis.

Pension Plan Status

The value of assets versus benefits payable has improved substantially due to the higher rate of return and the deposit of proceeds from the sale of pension obligation bonds (POB). The projected June 2006 gross funding status is approximately 97.3 percent for the county's safety and miscellaneous plans. On a net basis, taking into account the POB liability, the ratio is 87.0 percent, representing an improvement of 4.0 percent since June 2004.

CalPERS' investment performance has been encouraging and exceeded the system's assumed actuarial rate of return; performance over the last three years has averaged 12.5 percent, compared to a 7.6 percent from 1997 to 2003.

The county's employer-rate outlook is positive, based upon improved investment performance and a higher funding ratio. CalPERS also has introduced a new rate smoothing technique that will make rates less volatile. Actuarial projections show that sustained deviation from the assumed rate of 7.75 percent will now take seven to 10 years to move rates up or down.

Financing Status report

As mentioned above, bond issues helped improve funding status and reduce rates. From an economic perspective, our actuarial report indicated a **benefit of over \$38 million** since their issuance in 2005. One aspect of our POB structure was to capture a portion of the savings and use it to accelerate scheduled debt reduction. Thus,

although we are 97.3 percent funded, the 2.7 percent unfunded portion equates to a \$105.5 million liability. The committee therefore has recommended sending the \$5.1 million balance to CalPERS with instructions to pay down the existing liability.

Many pension systems, including CalPERS, have for years offered early payment discounts in lieu of periodic payments coinciding with payroll disbursements. PARC first recommended seizing this opportunity in 2004 and continues to do so. **This year's prepayment is expected to generate \$2 million in cash-flow benefit, coming on the heels of prior-year savings totaling \$4.4 million.**

Pension Reform

Spurred by proposals to address looming imbalances in the Social Security retirement program, pension reform at the state and local level became the subject of great political debate but of little legislative action in 2005.

New Issues

The committee has had numerous discussions regarding our liability with respect to other post-employment benefits (OPEB), the substantial portion being retiree health care costs. Recent actuarial reports show substantial liability, although much smaller than many other public agencies in the state. Because of the liability, the Human Resources Department is examining different benefit alternatives to manage this exposure. The committee is prepared to study the matter and make additional recommendations.

Because of legislation that enables enhanced pension benefits for miscellaneous employees, a number of employees do not get full credit at the higher rate for their years of service with related county entities. As more information becomes available regarding the cost of various options to address this issue, the committee will pass that along for Board consideration.

Recommendations

- 1 Receive and file the FY 2005/06 PARC report.
- 2 Adopt the recommendation to use money in the liability management fund to reduce the county's CalPERS liability and authorize staff to transfer funds to CalPERS. The amount available for transfer is estimated to be \$5.1 million for FY 05/06.
- 3 Designate the PARC as the clearinghouse for discussions of the financial aspects of Other Post Employment Benefits (OPEB) and direct the PARC to report back to the Board on a timely basis regarding financial strategies to deal with OPEB liabilities.

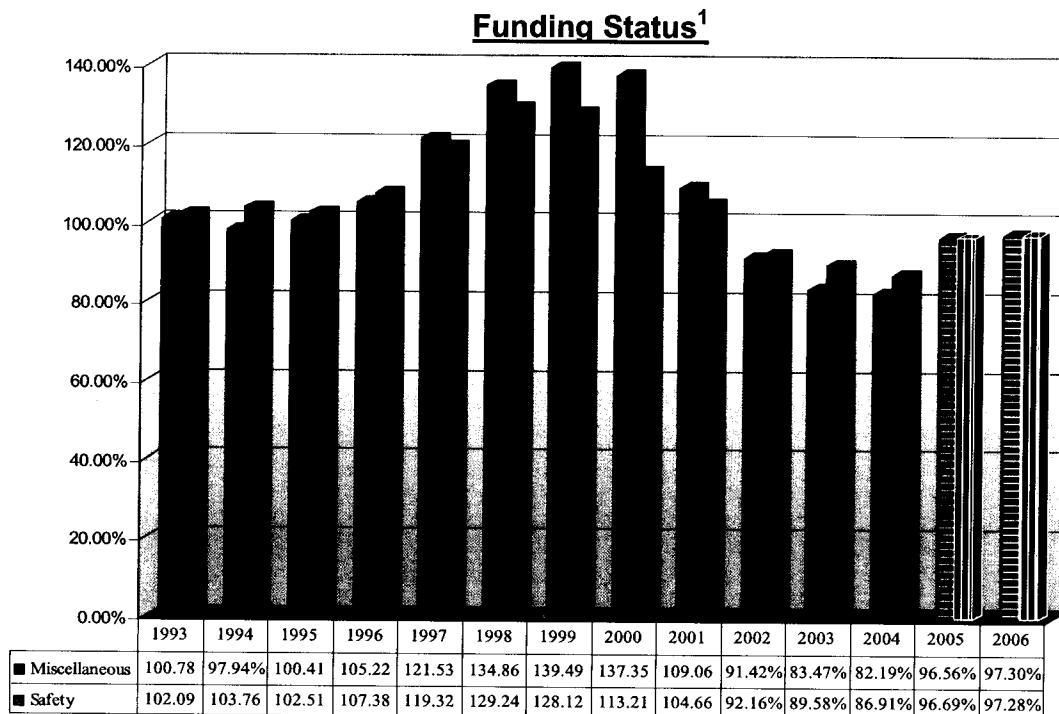
II Plan Funding Status

Funding status, the value of assets versus benefits payable, has increased due to improved investment returns and the partial refunding of the county's unfunded actuarial liability.

Current Funding Status. Bartel & Associates forecasts that as of June 30, 2006, the county will have an unfunded liability of \$72.7 million for the miscellaneous plan and \$32.8 million for the safety plan. (The most recent CalPERS report has a valuation date of June 30, 2004, thus the need to forecast. See Appendix.) This 80 percent decrease in the unfunded liability from the 2004 level is due to a \$400 million increase in assets financed by issuing pension obligation bonds and from improved investment returns at CalPERS.

The projected June 2006 CalPERS funding status for the miscellaneous and safety plans is 97.3 percent and 97.3 percent, respectively. On a net basis (including the outstanding POB liability of \$396 million) the funding levels are 85.2 percent for the miscellaneous plan and 90.8% for the safety plan.

The following graph shows the miscellaneous and safety plans' funded status over the last several years (expressed as a ratio of asset to liability):

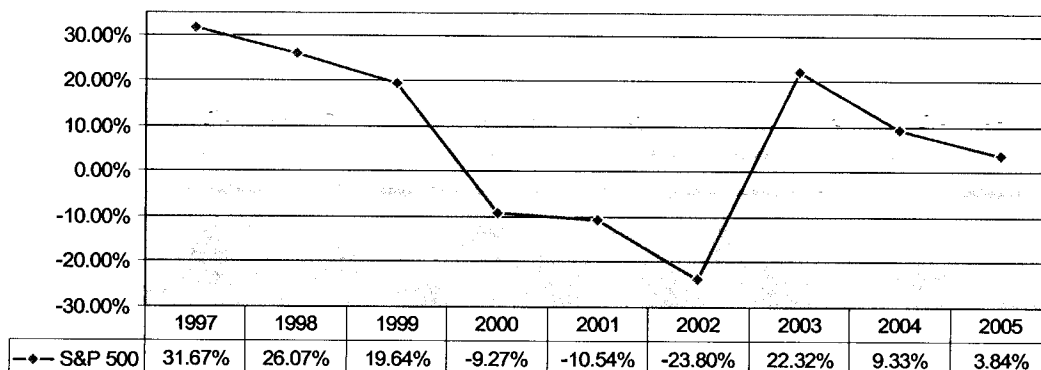


¹ Gross funding only. Accounting for bond liability reduces the net funding levels to 85.2 percent and 90.8 percent for the miscellaneous plan and the safety plan, respectively.

III CalPERS Investment Performance

Market Summary. Most of the recent market and economic news has been positive; since January, the Dow Jones Industrial Average is up approximately 6 percent with the S&P 500 and NASDAQ following suit. In addition, the federal funds rate is now 5 percent and yields on other fixed-income securities have moved upward. Although slowing, the real-estate market has held steady and CalPERS has taken gains on a number of its real estate investments.

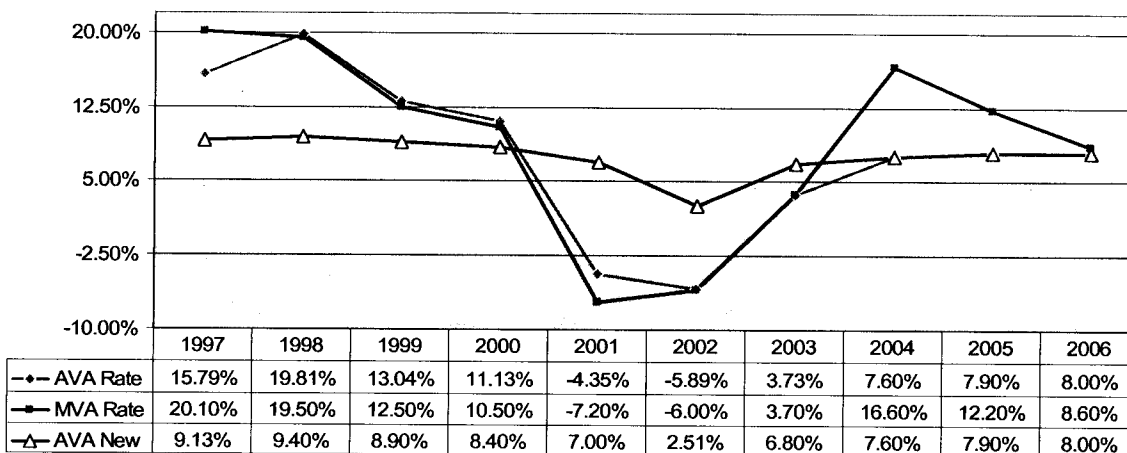
S&P 500 Annual Returns



Current Return (MVA)². From 2004 to 2006, CalPERS returned 10.4 percent, bringing the average rate of return (MVA) since 2000 to 5.5 percent. This includes the years of severe market downturn following the burst of the “dot com” bubble.

CalPERS’ investment performance has generally mirrored performance in the capital markets.

CalPERS Annual Returns⁽³⁾



Source: Bartel & Associates

² CalPERS refers to the actual market return as MVA rate and the “actuarial rate of return” as AVA; the AVA is CalPERS “smoothed” rate of return and it is the rate used to value assets on deposit with CalPERS.

³ Annual returns for Miscellaneous and Safety plans weighted by asset values

The recent improved investment return has improved CalPERS' actuarial rate of return. For 2006, the projected annual market rate of return is greater than the assumed actuarial rate of return of 7.75 percent. This indicates that the current actuarial rate of return of 8 percent will meet or exceed that rate of return. The following are five- and 10-year average market returns and actuarial returns for the former smoothing method and the new smoothing method.

Market and Actuarial average rates

	5 Year Average	10 Year Average
AVA Rate	4.3%	7.7%
MVA Rate	7.0%	9.1%
AVA New	6.6%	7.6%

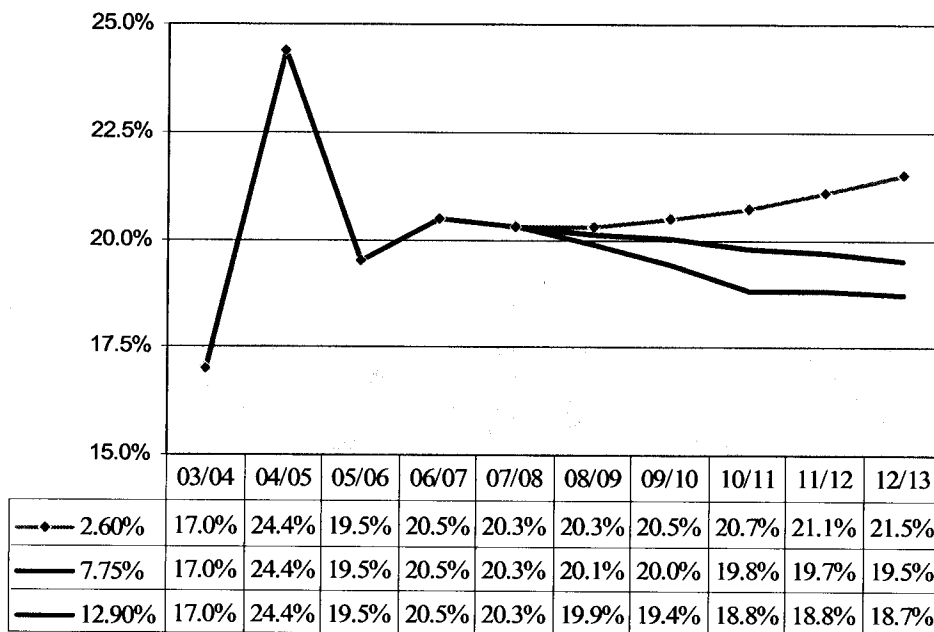
IV Employer Rate Outlook

The county's employer rate outlook is optimistic, based on improved investment performance and a higher funding ratio. CalPERS also has introduced a new smoothing technique that will make rates less volatile.

Actuarial projections show that sustained deviation from the assumed rate of 7.75 percent will now take seven to 10 years to move actual actuarial rates up or down. If CalPERS were to underperform for a sustained period, the effect would be delayed and it would take longer to return to the target rate. This is not an immediate concern but the county might consider making more payments than CalPERS requires as a hedge against sustained underperformance in such a case.

In the graph below, employer rate projections are shown for three different investment return scenarios.

Projected Safety Contribution⁴

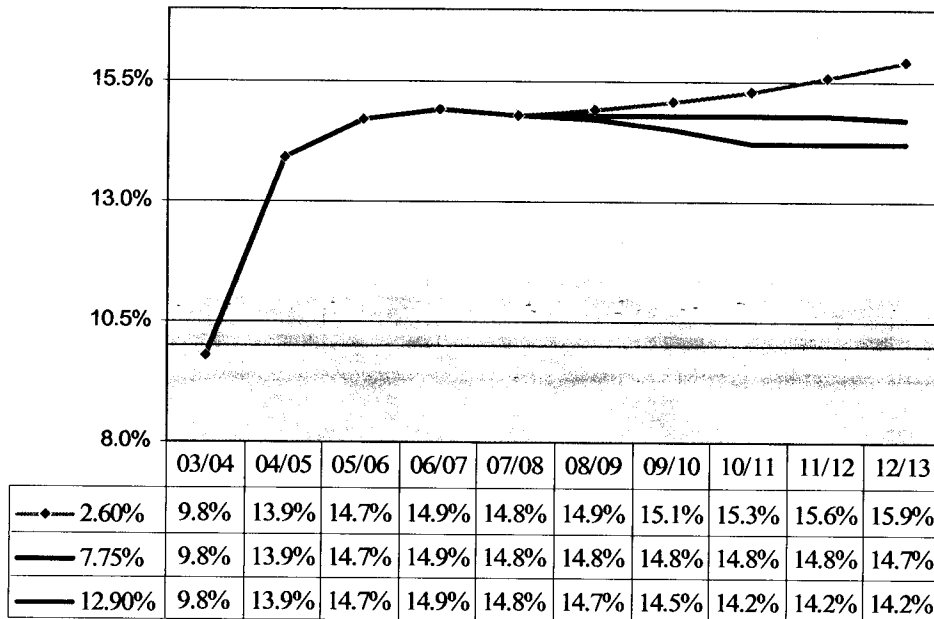


Source: Bartel Associates

⁴ Includes POB debt service. The three investment scenarios correspond to the 75%, 50% and 25% confidence level, see Appendix.

In the graph below, employer rate projections are shown for three different investment return scenarios.

Projected Miscellaneous Contribution⁵



Source: Bartel Associates

⁵ Includes POB debt service. The three investment scenarios correspond to the 75%, 50% and 25% confidence level, see Appendix.

V Pension Obligation Bond

The county sold a \$400 Pension Obligation Bond (POB) in February 2005 and the county made its first payment on Aug. 15, 2005. Contemporaneous projections show the POBs were expected to save \$161.8 million over the life of the bonds. The projections assume CalPERS earns its 7.75 percent assumed actuarial rate of return over the life of the bonds. The "break-even" rate for the bond transaction is 4.91 percent, the rate on the POBs.

To date, based upon the analysis of independent actuary John Bartel, the county has saved \$38.5 million, as shown in the calculation below.

Analysis of Performance to date⁶

+	CalPERS Investment Earnings	\$60.5
-	POB Interest Payments	18.9
-	<u>Cost of Issuance</u>	<u>3.1</u>
=	Net Savings	\$38.5

Liability Management Fund. One key aspect incorporated into the POB structure is the liability management fund. The fund collects an amount representing 50 percent of the projected savings that would otherwise be passed on to departments. The purpose is to accelerate repayment of the county's pension liabilities, reducing pension costs in the long term and reducing the marginal risk associated with issuing POBs.

PARC policy dictates that at the end of the year the committee is to recommend whether the funds should pay down any liability at CalPERS or buy down POBs. The committee determined that using the approximately \$5.1 million on hand, paying down CalPERS liability was the appropriate course this year. In future years, buying down POBs might be a better use of funds, depending upon our funding status at CalPERS, interest rates and the amount of cash on hand.

It should be noted that the original POB structure included a significant variable-rate component. Because variable-rate bonds are easily callable, the liability management fund also was intended to serve as an interest rate risk-management tool; funds on hand could be used to facilitate redemption if rates were to rise. Approximately 30 percent of the POBs initially were structured in this mode. That portion eventually was sold as fixed-rate bonds in 2005 because the county was able to lock in an average rate of 4.91 percent. **The liability management fund, thus, no longer functions to mitigate interest-rate risks. Had those bonds been sold in the variable-rate mode their rate currently would exceed 5 percent.**

⁶ Provided by Bartel Associates. It should be noted that there could be any number of alternative calculation methods, but the results would not vary substantially at this point.

VI CalPERS Annual Prepayment

One of the first steps PARC initiated was the annual prepayment program. CalPERS offers participants a discount for prepaying its projected annual employer's pension cost in a lump sum at the beginning of the fiscal year. The discount amounts to 50 percent of CalPERS' projected actuarial return.

In FY 2004/05 the general fund netted \$2.9 million by executing the CalPERS prepayment program, which takes advantage of the prepayment discount and associated internal cash flows.

For FY 2005/06 the general fund is scheduled to net \$1.5 million by prepaying the 2005/06 "normal" pension cost. The 48 percent drop in savings from 2004/05 to 2005/06 is due to the increase in short-term borrowing costs.

For FY 2006/07 the county is obligated to pay \$107 million⁷, which is the employer's projected contribution for "normal" pension cost.

The PARC will recommend that 70 percent of the projected annual pension cost be prepaid. Savings for prepaying the normal cost for fiscal year 2006/07 is \$2 million (see graph below). Savings for 2006/07 will be enhanced by the following:

- Diminution in borrowing cost due to the now tax-exempt nature of the issuance
- Acceleration of deposits to the structured investment agreement by a week.

Summary Prepayment Savings (000,000's)

	FY 2004	Projected FY 2005	Projected FY 2006 (70%)
Total Normal Cost	\$ 119.41	\$ 97.74	\$ 107.05
Normal Cost Prepaid	107.47	87.96	74.94
+ PERS discount	4.18	3.22	2.75
+ Interest earned	1.47	1.59	1.99
- Net Borrowing cost	2.73	3.31	2.63
= Savings	\$ 2.92	\$ 1.50	\$ 2.00

⁷ Amount is projected by CalPERS, actual obligation may differ.

VII Pension Reform

Public pension reform. In 2005, significant, but unsuccessful, efforts were made to reform California public pension plans. The governor introduced and later withdrew a petition initiative, and numerous special-session legislative proposals were debated. This year there has been little activity. Only one significant pension reform proposal has been introduced: ACA 23 (Assemblyman Keith Richman's proposal) would require new public employees to participate in a "hybrid" retirement program consisting of a mandatory defined benefit and an employee-optional matching defined-contribution plan. ACA 23 is expected to be defeated later this year and may, according to its author, serve as a future petition initiative proposal. Private discussions between the governor and legislative leaders to establish a pension-reform commission have failed to materialize results.

Mr. Richman's pension reform effort in 2006 has been limited to one measure, AB 1961. The bill would have required the Bureau of State Audits to audit the CalPERS actuarial function and file a specified report. The bill was defeated at its first hearing before the Assembly Public Employees Retirement and Social Security Committee.

Rumors persist that Mr. Richman will pursue a ballot initiative in 2008 to address public pension reform. If he opts for that approach, public-employee unions are expected to mobilize their members, and a well-funded advertising campaign, against such an initiative.

VIII OPEB Liability

Coming hard on the heels of disclosures about large unfunded pension liabilities, public agencies are grappling with the requirements imposed by the Government Accounting Standards Board Rule Number 45 (GASB 45). Beginning June 30, 2007 public agencies' financial statements must disclose their OPEB commitments, the lion's share of which are retiree healthcare benefits.

GASB's requirement is the corollary to corporate standards that have existed for over a decade (FASB 106). Neither requires immediate or full funding to meet these liabilities, nor is there an immediate balance-sheet impact. Disclosures are recorded "off balance sheet," similar to current accounting rules for pension-plan assets and liabilities. The financial impact is realized year by year as the cost of meeting those obligations is incurred.

Funding retiree healthcare costs in the face of spiraling healthcare costs and increasing longevity is a major challenge for corporations and government. **Put in perspective, General Motors has an unfunded liability of \$85 billion⁸**, but the company's current market capitalization is only \$13.86 billion.

Thus, it is not surprising that the trend for corporations has been to move away from employer-paid retiree health benefits. That move is due more to the actual impact of rising healthcare costs on the bottom line than to the impetus to disclose. Disclosing the ongoing liability simply allows stakeholders to better understand that impact.

Decision makers in the public agency arena are at the front end of the learning curve. Many agencies, including Riverside County, are having the required studies prepared and are assessing their options. Credit rating agencies made it very clear in recent discussions that they want full and immediate disclosure about our liabilities and the steps being taken to address them.

Our most recent actuarial study shows over 71 percent of Riverside County's liability is due to the implicit subsidy that results from including retirees in the same rate pool as active employees. GASB 45 treats this subsidy as an employer obligation regardless of the fact that the commitment to retirees might be a fixed dollar amount. In fact, active employees bear the immediate brunt of the pooling in the form of higher insurance rates.

Human Resources will be presenting a number of recommendations to address the benefit side of the issue. The committee believes it is the proper forum to look at financial and funding strategies.

⁸ New York Times, 5/19/2006, "Japanese Cars, American Retirees"

IX. Miscellaneous Issues

Because of legislation that enables enhanced pension benefits for miscellaneous employees, a number of employees do not get full credit at the higher rate for their years of service with related county entities (i.e., Flood, Waste and Parks). As more information becomes available regarding the cost of various options to address this issue, the committee will raise the topic for Board consideration.

X. Recommendations

- 1 Receive and file the FY2005/06 PARC report.
- 2 Adopt the recommendation to use money in the liability management fund to reduce the county's CalPERS liability and authorize staff to transfer funds to CalPERS.
- 3 Designate the PARC as the clearinghouse for discussions of the financial aspects of Other Post Employment Benefits (OPEB) and direct the PARC to report back to the Board on a timely basis regarding financial strategies to deal with OPEB liabilities.

XI. Acknowledgements

This report was prepared with input from committee members and staff. County Public Officer Ray Smith applied his editorial skills.

Significant assistance was provided by John Bartel & Associates. Various sources were used and, where appropriate, identified specifically. Text references generally have not been footnoted. The CSAC 2006 rating agency briefing materials were a useful source and the county's Sacramento legislative advocate, Michael Corbett, provided valuable insight on the status of pension reform.

APPENDIX 1
Bartel Associates Report



**COUNTY OF RIVERSIDE
ALL PLANS**

CalPERS Actuarial Issues – 6/30/04 Valuation

JOHN E. BARTEL

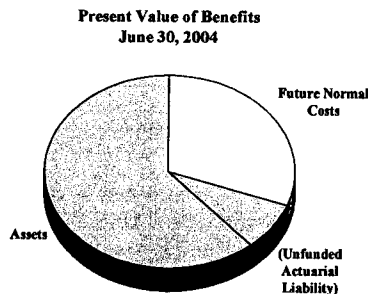
BARTEL
ASSOCIATES, LLC

February 6, 2006 (Revised 5/3/06)

<u>Topic</u>	<u>Page</u>
Definitions	1
<u>Safety</u>	
Plan Funded Status	4
Demographic Information	7
Plan Assets	11
Actuarial Obligations	15
Contribution Rates	17
Contribution Projections	19
<u>Miscellaneous</u>	
Plan Funded Status	23
Demographic Information	25
Plan Assets	29
Actuarial Obligations	33
Contribution Rates	35
Contribution Projections	39
POB	41
CalPERS Rate Smoothing	45



Definitions



- **PVB - Present Value of all Projected Benefits:**
 - Discounted value (at valuation date - 6/30/04), of all future expected benefit payments based on various (actuarial) assumptions
- **Actuarial Liability:**
 - Discounted value (at valuation date) of benefits earned through valuation date [value of past service benefit]
 - Portion of PVB “earned” at measurement
- **Current Normal Cost:**
 - Portion of PVB allocated to (or “earned” during) current year
 - Value of employee and employer current service benefit

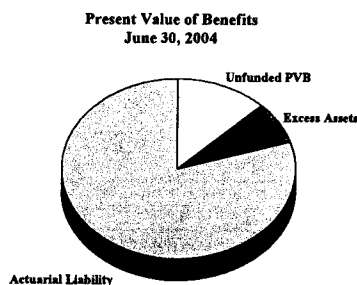


Revised 5/3/06

1



Definitions



- **Target-** Have money in the bank to cover Actuarial Liability (past service)
- **Unfunded Liability -** Money short of target at valuation date
- **Excess Assets / Surplus:**
 - Money over and above target at that point in time.
 - Doesn't mean you're done contributing.
- **Super Funded:**
 - Assets cover whole pie (PVB)
 - If everything goes exactly like PERS calculated, you'll never have to put another (employer or employee) dime in.

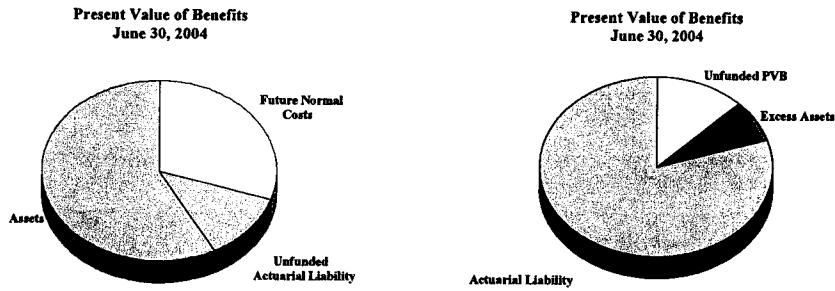


Revised 5/3/06

2



Definitions



- Contribution =
 - Normal Cost
 - + Unfunded Liability Amortization
 - or
 - - Excess Asset Amortization



Revised 5/3/06

3



Plan Funded Status

- Future events that might cause rate fluctuations:
 - Asset Gains/Losses:
 - Smoothing will not mitigate upcoming asset losses
 - Experience Gains/Losses (somewhat mitigated because of smoothing):
 - Disabilities
 - Salaries
 - Retirements
 - Pooling
 - Air Time Service Purchase

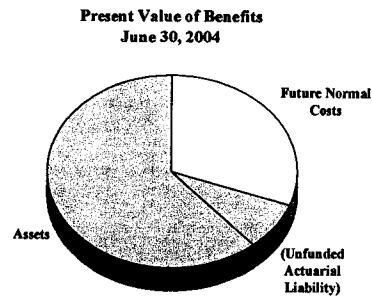
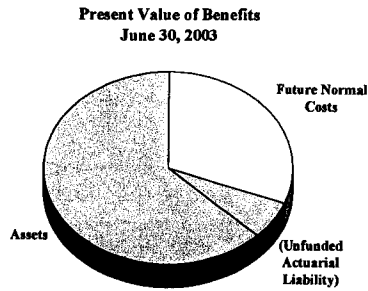


Revised 5/3/06

4



Plan Funded Status Safety



<u>June 30, 2003</u>		Unfunded PVB	<u>June 30, 2004</u>	
\$	443,400,000		\$	507,200,000
	(94,500,000)	(Unfunded Liability)		(133,700,000)
	<u>906,500,000</u>	Actuarial Liability		<u>1,021,100,000</u>
	1,255,400,000	PVB		1,394,600,000



Revised 5/3/06

5



Plan Funded Status Safety

- What happened between 6/30/03 and 6/30/04?
 - Asset gain/(loss): ≈ (4.9) million
 - Actuarial gain/(loss): ≈ (34.0) million
 - Average Salary \$54,500 → \$60,200
 - Number of Actives 2,708 → 2,684
 - Number of Inactives 776 → 811
 - Number of Retirees 1,090 → 1,168
 - CalPERS Method Changes: ≈ 3.9 million
 - Contribution gain/(loss): ≈ 2.6 million
 - Expected ≈ (39.6)
 - Actual ≈ 42.2
 - Expected UAL (Increase): ≈ (6.8) million

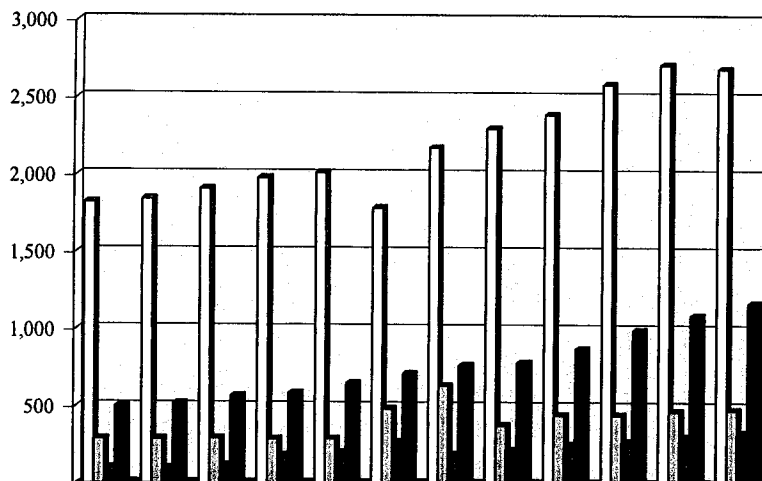


Revised 5/3/06

6



Members Included in Valuation Safety



	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
□ Active	1,820	1,839	1,906	1,976	2,010	1,782	2,172	2,296	2,385	2,581	2,708	2,684
▨ Transfers	288	289	294	289	292	485	636	378	444	444	470	479
■ Vested Terminations	103	100	119	185	205	269	189	217	254	274	306	332
■ Receiving Payments	501	520	567	586	651	711	767	785	872	993	1,090	1,168

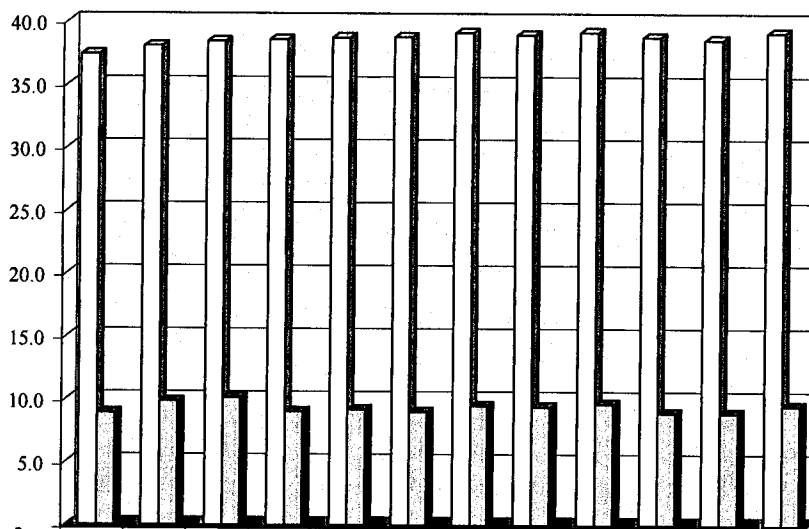


Revised 5/3/06

7



Average Age/Service Safety



	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
□ Average Age	37.4	38.1	38.4	38.6	38.7	38.8	39.1	39.0	39.2	38.8	38.6	39.1
▨ Average Service	8.9	9.8	10.1	9.0	9.2	9.0	9.5	9.4	9.6	8.9	8.9	9.5

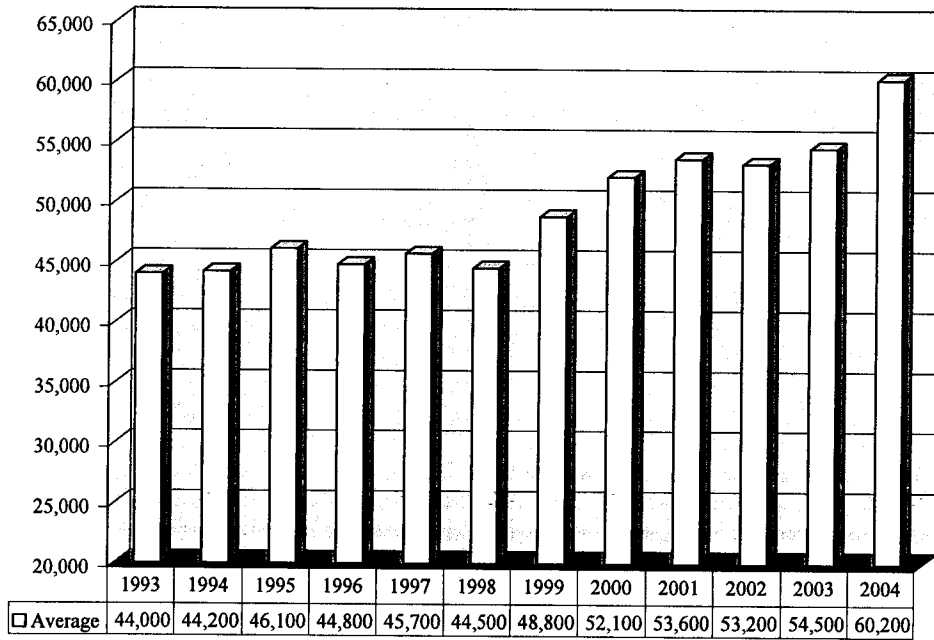


Revised 5/3/06

8



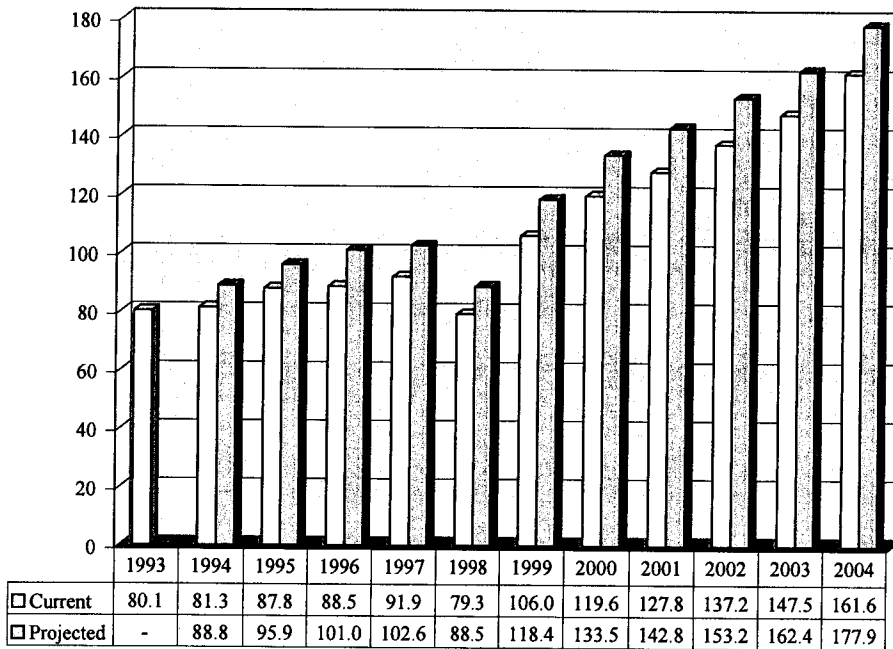
Average PERSable Wages Safety



Revised 5/3/06



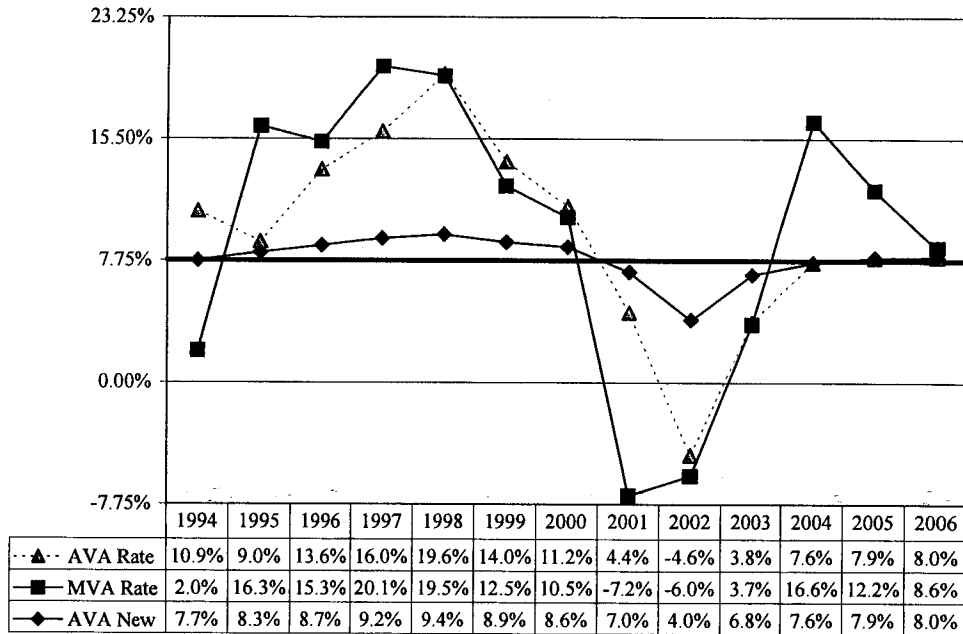
Total Annual PERSable Wages (Millions) Safety



Revised 5/3/06



Actuarial Investment Return Safety



Revised 5/3/06

11



Actuarial Investment Return Safety

- Above assumes contributions, payments, etc. received evenly throughout year.
- 6/30/04:
 - Market Value return ≈16.57%
 - Actuarial Value return ≈ 7.6%
- 6/30/05:
 - Market Value return ≈12.26%
 - Actuarial Value return ≈ 7.9%
- 6/30/06:
 - Market Value return through 10/31/05 ≈ 3.30%
 - Estimated Annualized MVA Return ≈ 8.6%
 - Estimated Annualized AVA Return ≈ 8.0%

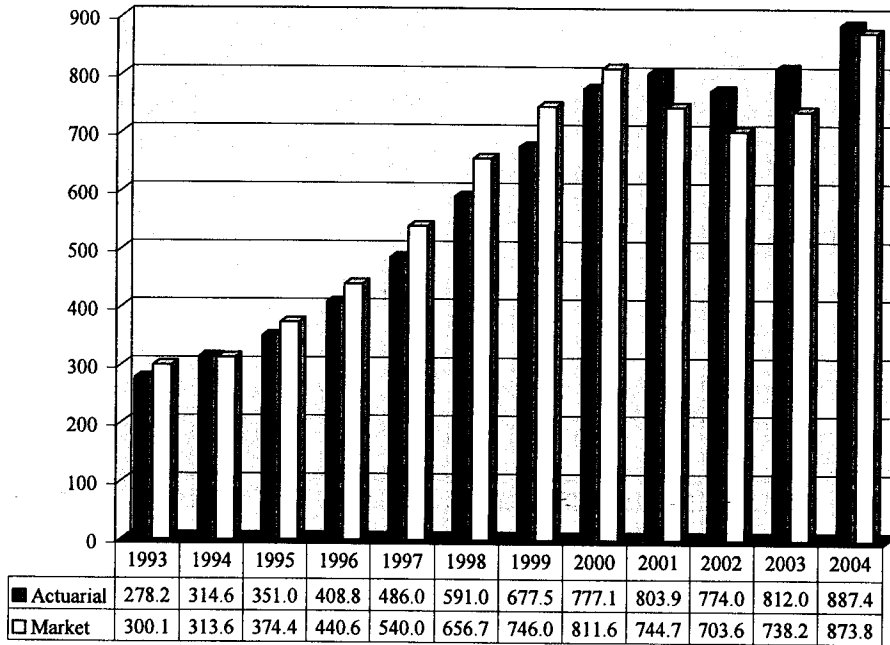


Revised 5/3/06

12



Asset Values (Millions) Safety



Revised 5/3/06



Asset Values Safety

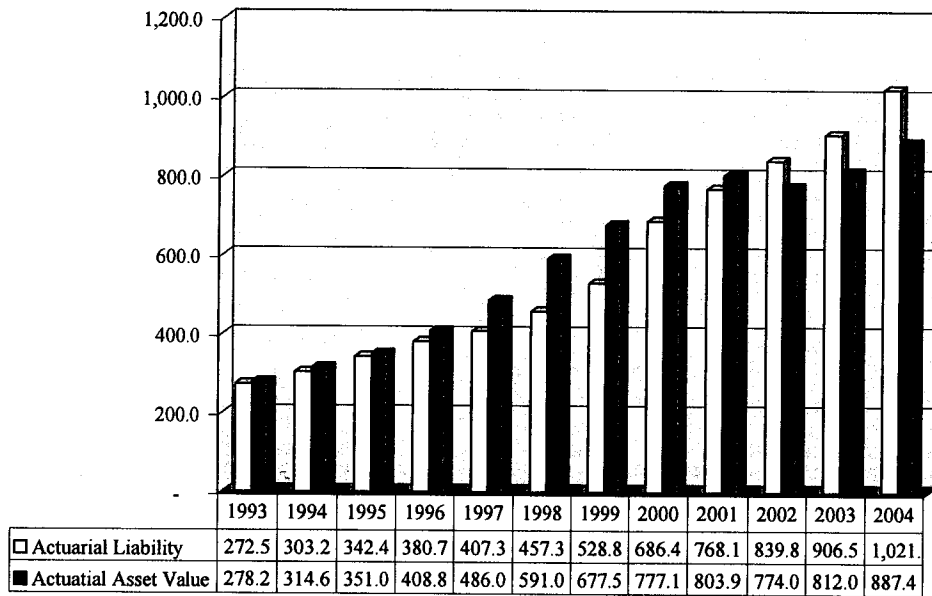
- 6/30/00 Actuarial Value ≈ 96% Market
- 6/30/01 Actuarial Value ≈ 108% Market
- 6/30/02 Actuarial Value ≈ 110% Market
- 6/30/03 Actuarial Value ≈ 110% Market
- 6/30/04 Actuarial Value ≈ 101% Market
- 6/30/05 Actuarial Value will be ≈ 98% Market



Revised 5/3/06



Funded Status (Millions) Safety



Revised 5/3/06



Funded Status Safety

- Actuarial assumptions:
 - Interest rate
 - General inflation 3.00%
 - Real rate of return 4.75
 - Total 7.75
 - Payroll growth 3.25%

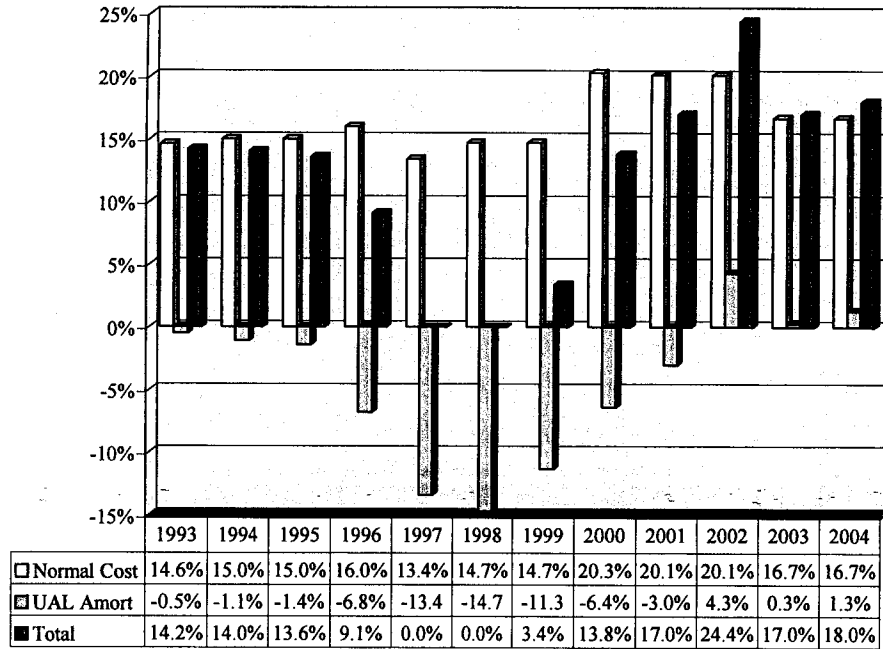
- Investment gains – Impact on funded status:
 - 6/30/05 [12.26% compared to 7.75%] +4.5%
 - Actuarial asset “reserve” -1.6%
 - Total estimated % gain 3.0%
 - Total estimated unrecognized gain \$ 21.8 million
[3.0% x \$ 738 million]



Revised 5/3/06



Contribution Rates Safety



Revised 5/3/06

17



Contribution Rates Safety

	Pre-POB 6/30/03 <u>2005/2006</u>	Post-POB Incl. Debt Svc 6/30/03 <u>2005/2006</u>	6/30/04 <u>2006/2007</u>	Incl. Debt Svc 6/30/04 <u>2006/2007</u>
■ Normal cost	16.7%	16.7%	16.7%	16.7%
■ Debt Service	-	2.5%	-	2.4%
■ Amortization bases:				
● Assumption Change	-1.3%	-	-	-
● Benefit Change 6/30/99	3.1%	-	-	-
● Benefit Change 6/30/00	0.8%	-	-	-
● Benefit Change 6/30/01	-0.1%	-	-	-
● (Gain)/Loss	11.4%	-	1.5%	1.5%
● Fresh Start	<u>-9.3%</u>	<u>0.3%</u>	<u>-0.2%</u>	<u>-0.2%</u>
Sub-total	<u>4.4%</u>	<u>0.3%</u>	<u>1.3%</u>	<u>1.3%</u>
● Total:	21.1%	19.5%	18.0%	20.4%
● Amortization period	≈ 20 years	30 years	30 years	30 years
■ What Happened from 6/30/03 to 6/30/04:				
● 2005/06 Rate			17.0%	
● (Gains)/Losses			2.0	
● Method Changes			<u>-1.1</u>	
● 2006/07 Rate			18.0%	



Revised 5/3/06

18



Contribution Projections Safety

■ **Market Value Investment Return:**

- June 30, 2005 12.3%
- June 30, 2006 - 2010
 - 75% Confidence Limit*: ≈ 2.6%
 - 50% Confidence Limit: ≈ 7.75%
 - 25% Confidence Limit: ≈ 12.9%

*Confidence Limits – Actual Return will exceed the given rate with indicated probabilities

■ **Fresh Starts:**

- **30 Year Fresh Start for 06/07**
- 15 Year +0.7% 20 Year +0.3% 25 Year +0.1%

■ **No Other:**

- Gains or Losses
- Method or Assumption Changes
- Benefit Improvements

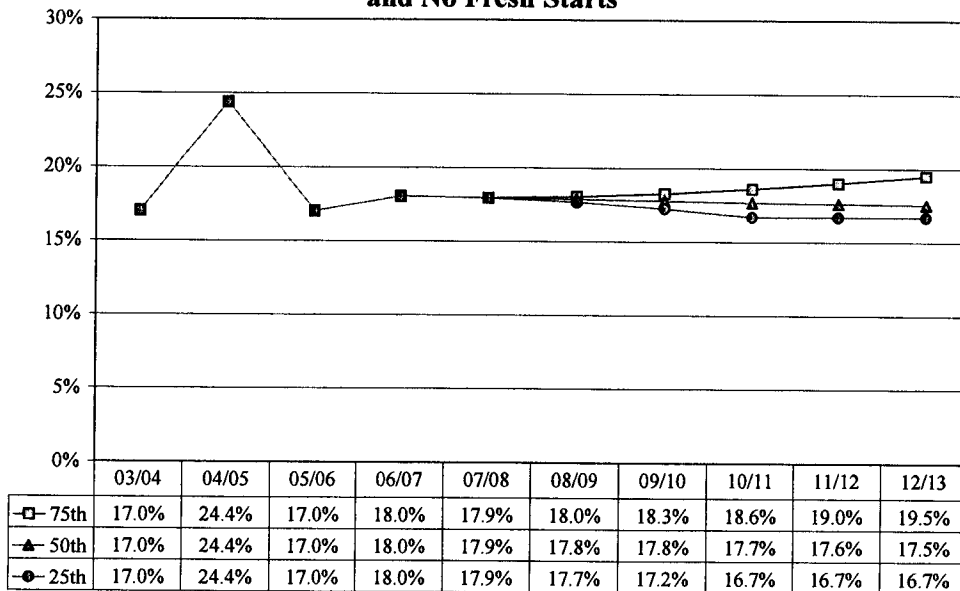


Revised 5/3/06



Contribution Projections Safety

Investment Return Varies and No Fresh Starts



Revised 5/3/06



Contribution Projections Safety

■ **Market Value Investment Return:**

- June 30, 2005 12.3%
- June 30, 2006 - 2010 75% Confidence Limit*: \approx 2.6%
- 50% Confidence Limit: \approx 7.75%
- 25% Confidence Limit: \approx 12.9%

*Confidence Limits – Actual Return will exceed the given rate with indicated probabilities

■ **Pension Obligation Bond (POB):**

- **Includes Debt Service on POB**

■ **No Other:**

- Gains or Losses
- Method or Assumption Changes
- Benefit Improvements

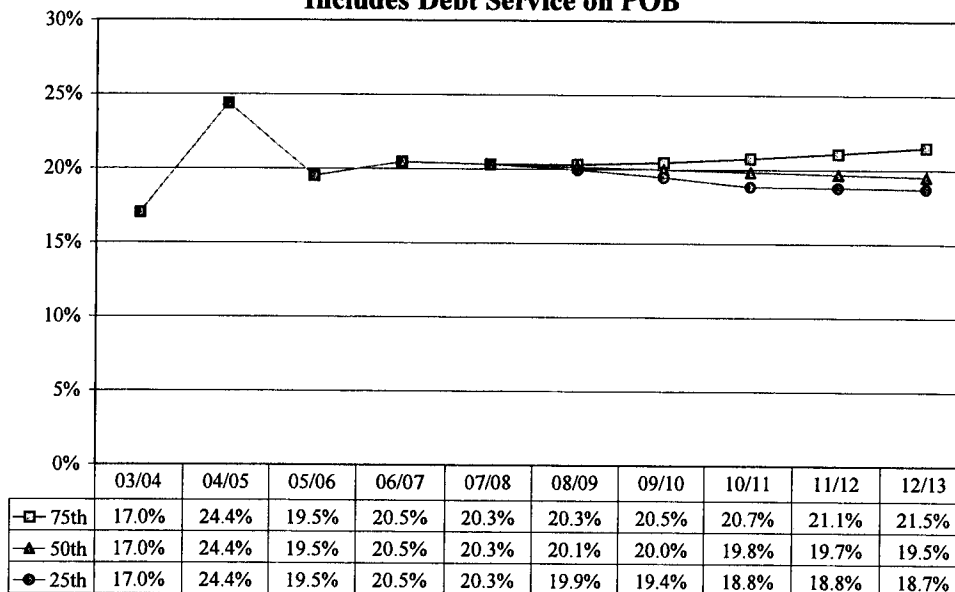


Revised 5/3/06



Contribution Projections Safety

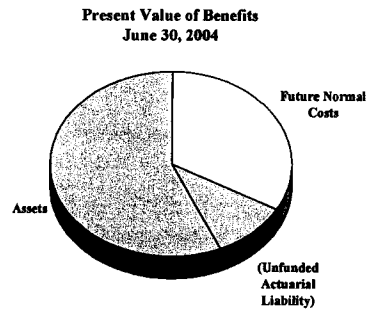
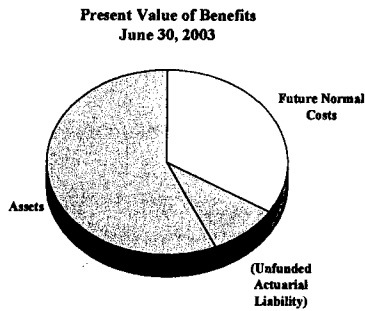
**Investment Return Varies
Includes Debt Service on POB**



Revised 5/3/06



Plan Funded Status Miscellaneous



<u>June 30, 2002</u>		<u>June 30, 2003</u>
\$ 1,193,300,000	Unfunded PVB	\$ 1,301,200,000
(330,400,000)	(Unfunded Liability)	(397,500,000)
1,998,800,000	Actuarial Liability	2,231,600,000
2,861,700,000	PVB	3,135,400,000



Revised 5/3/06

23



Plan Funded Status Miscellaneous

- What happened between 6/30/03 and 6/30/04?
 - Asset gain/(loss): ≈ (9.8) million
 - Actuarial gain/(loss): ≈ (33.3) million
 - Average Salary \$42,800 → \$45,100
 - Number of Actives 12,671 → 12,664
 - Number of Inactives 5,489 → 5,867
 - Number of Retirees 4,815 → 5,146
 - CalPERS Method & Assumption Changes: ≈ 7.9 million
 - Contribution gain/(loss): ≈ 1.3 million
 - Expected ≈ (97.8)
 - Actual ≈ 99.1
 - Expected UAL (Increase): ≈ (33.0) million

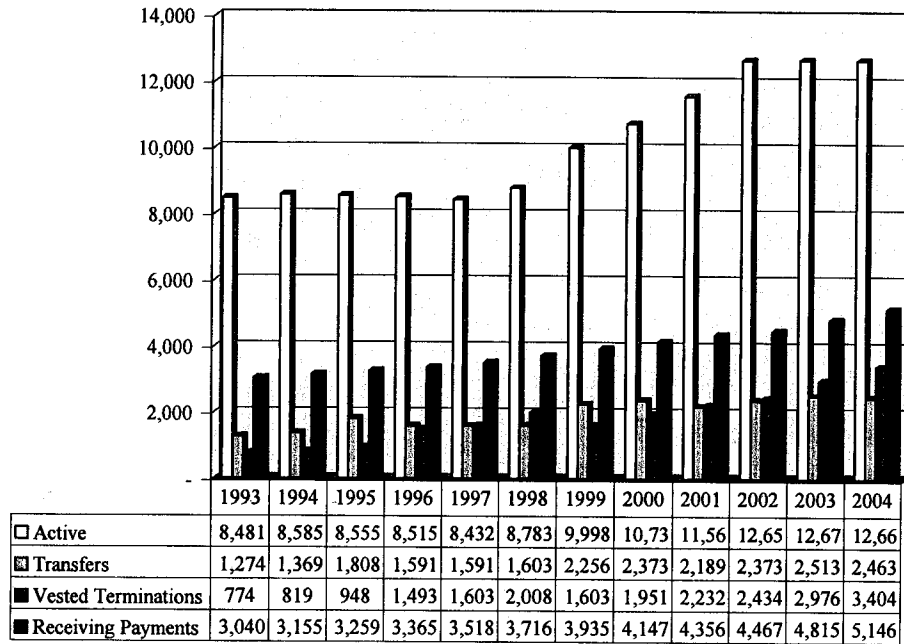


Revised 5/3/06

24



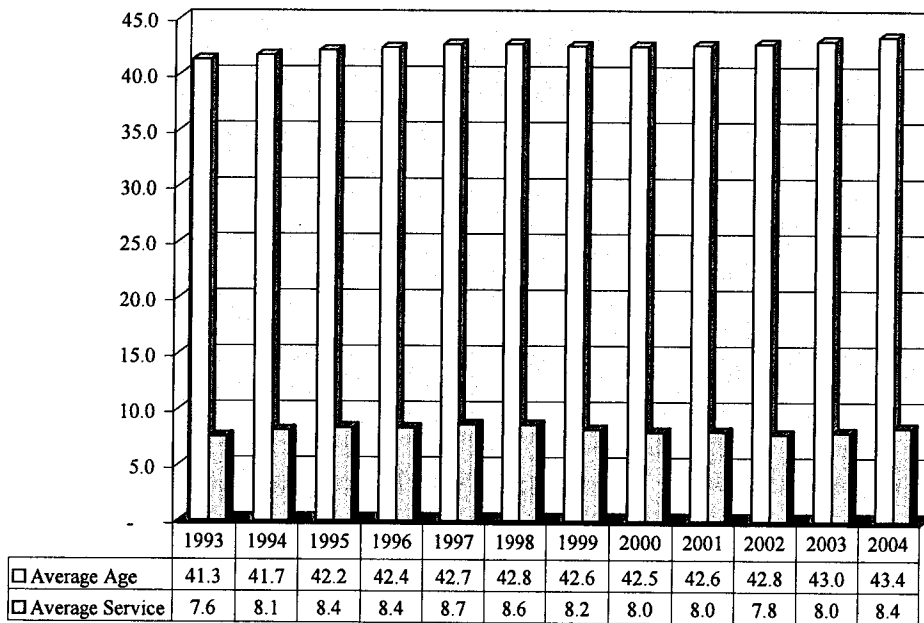
Members Included in Valuation Miscellaneous



Revised 5/3/06



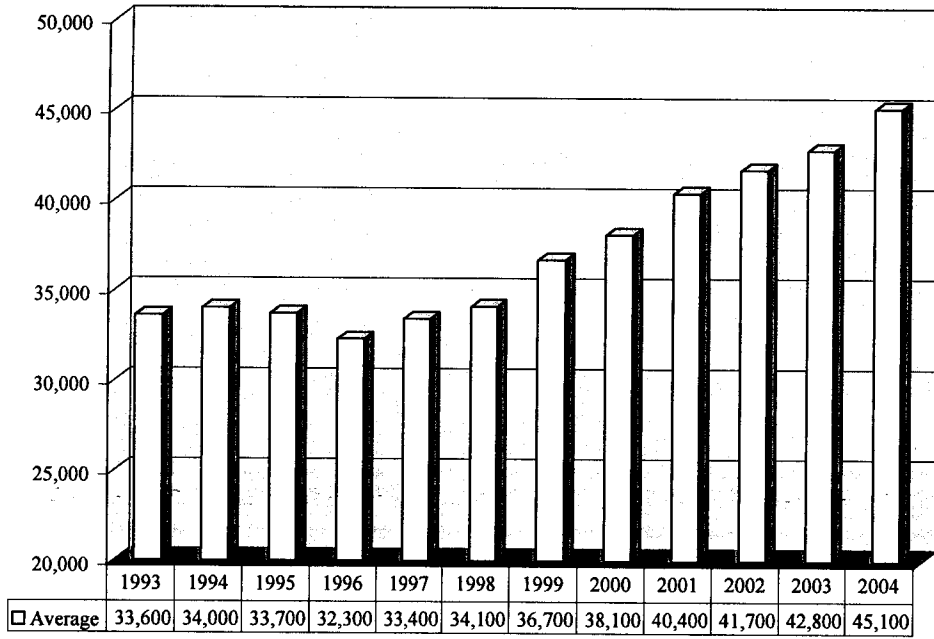
Average Age/Service Miscellaneous



Revised 5/3/06



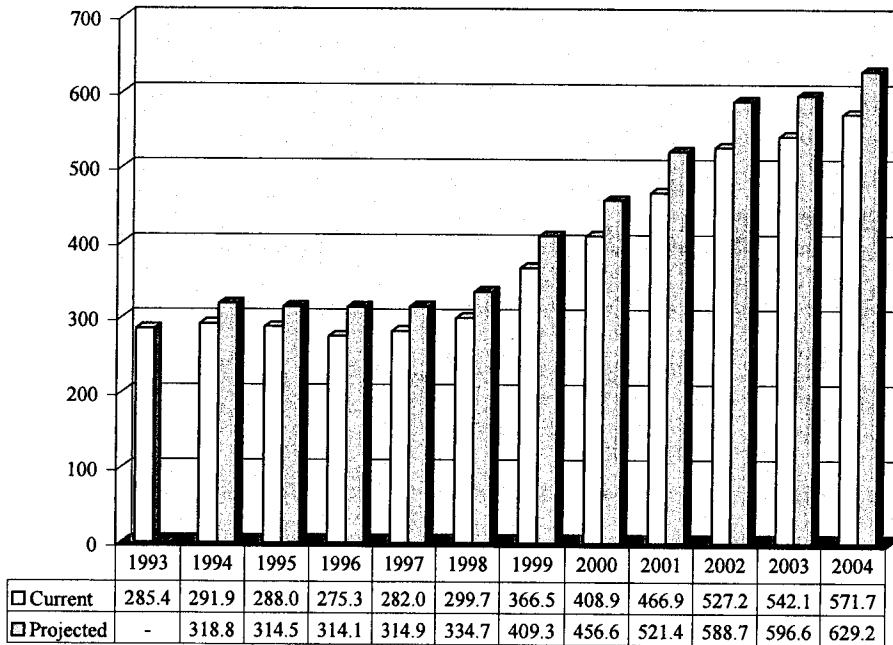
Average PERSable Wages Miscellaneous



Revised 5/3/06



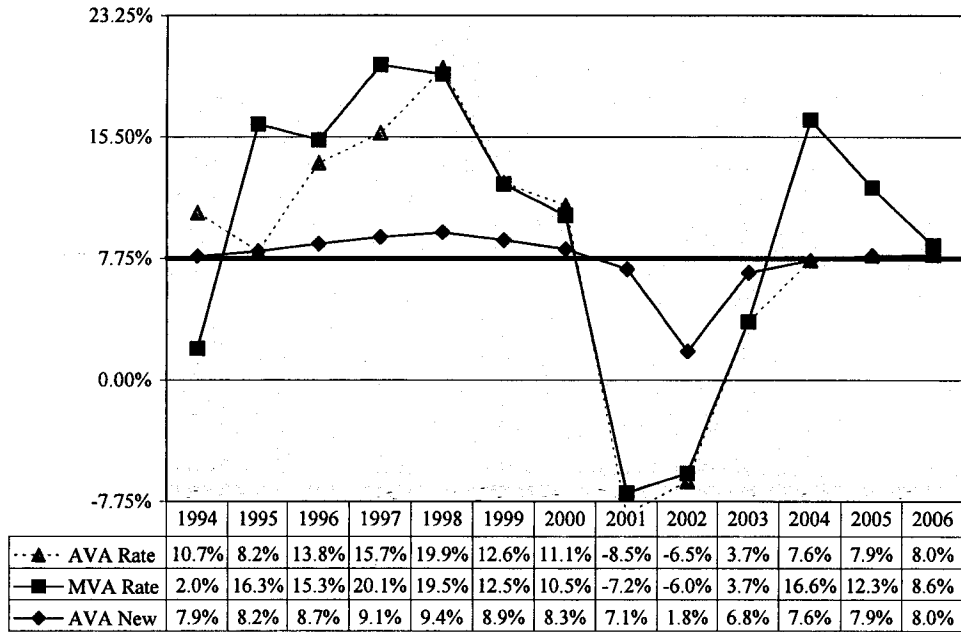
Total Annual PERSable Wages (Millions) Miscellaneous



Revised 5/3/06



Actuarial Investment Return Miscellaneous



Revised 5/3/06

29



Actuarial Investment Return Miscellaneous

- Above assumes contributions, payments, etc. received evenly throughout year.
- 6/30/04:
 - Market Value return ≈ 16.57%
 - Actuarial Value return ≈ 7.6%
- 6/30/05:
 - Market Value return ≈ 12.26%
 - Actuarial Value return ≈ 7.9%
- 6/30/06:
 - Market Value return through 10/31/05 ≈ 3.30%
 - Estimated Annualized MVA Return ≈ 9.7%
 - Estimated Annualized AVA Return ≈ 7.9%

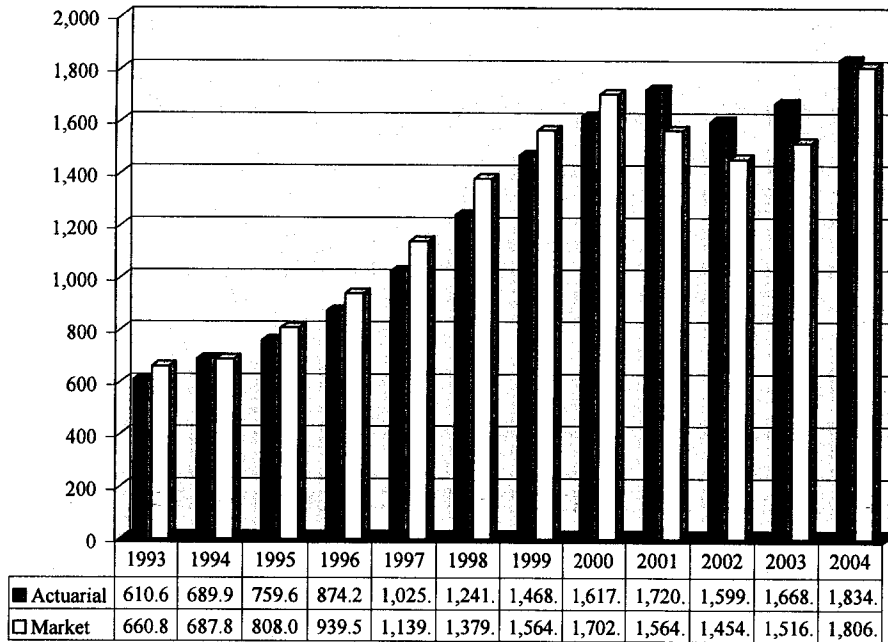


Revised 5/3/06

30



**Asset Values (Millions)
Miscellaneous**



Revised 5/3/06



**Asset Values
Miscellaneous**

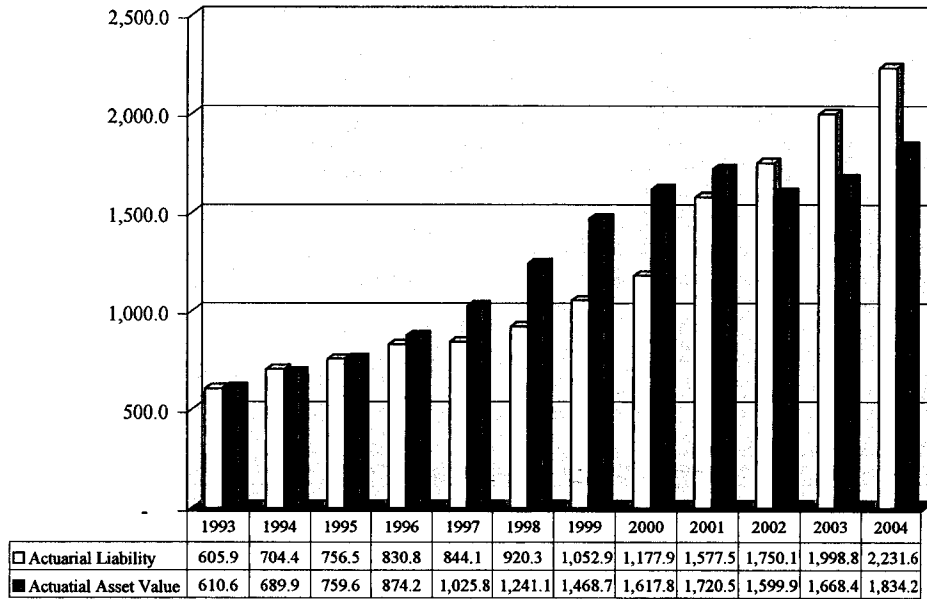
- 6/30/00 Actuarial Value ≈ 95% Market
- 6/30/01 Actuarial Value ≈ 110% Market
- 6/30/02 Actuarial Value ≈ 110% Market
- 6/30/03 Actuarial Value ≈ 110% Market
- 6/30/04 Actuarial Value ≈ 101% Market
- 6/30/05 Actuarial Value will be ≈ 98%% Market



Revised 5/3/06



**Funded Status (Millions)
Miscellaneous**



Revised 5/3/06



**Funded Status
Miscellaneous**

■ Actuarial assumptions:

- Interest rate
 - General inflation 3.00%
 - Real rate of return 4.75
 - Total 7.75
- Payroll growth 3.25%

■ Investment gains – Impact on funded status:

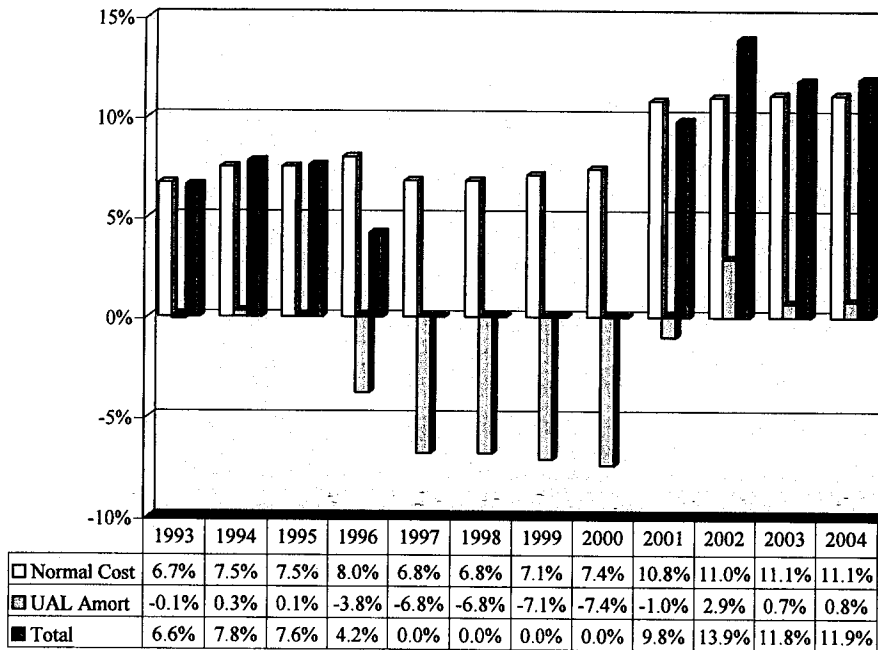
- 6/30/05 [12.26% compared to 7.75%] +4.5%
- Actuarial asset “reserve” -1.5%
- Total estimated % gain 3.0%
- Total estimated unrecognized gain \$ 45.3 million
[3.0% x \$ 1,517 million]



Revised 5/3/06



Contribution Rates Miscellaneous



Revised 5/3/06



Contribution Rates Miscellaneous

	Pre-POB 6/30/03 <u>2005/2006</u>	Post-POB Incl. Debt Svc 6/30/03 <u>2005/2006</u>	6/30/04 <u>2006/2007</u>	Incl. Debt Svc 6/30/04 <u>2006/2007</u>
■ Normal cost	11.1%	11.1%	11.1%	11.1%
■ Debt Service	-	2.9%	-	3.0%
■ Amortization bases:				
● Asset Change	-0.0%	-	-	-
● Assumption Changes	0.9%	-	-	-
● (Gain)/Loss	1.4%	-	0.9%	0.9%
● Fresh Start	<u>3.0%</u>	<u>0.7%</u>	<u>-0.1%</u>	<u>-0.1%</u>
Sub-total	<u>5.2%</u>	<u>0.7%</u>	<u>0.8%</u>	<u>0.8%</u>
● Total:	16.3%	14.7%	11.9%	14.9%
● Amortization period	≈ 20 years	17 years	30 years	30 years
■ What Happened from 6/30/03 to 6/30/04:				
● 2005/06 Rate			11.8%	
● (Gains)/Losses			0.7	
● Method Changes			<u>-0.6</u>	
● 2006/07 Rate			11.9%	



Revised 5/3/06



Contribution Rates Miscellaneous

■ **Market Value Investment Return:**

- June 30, 2005 12.26%
- June 30, 2006 - 2010 75% Confidence Limit*: \approx 2.6%
- 50% Confidence Limit: \approx 7.75%
- 25% Confidence Limit: \approx 12.9%

*Confidence Limits – Actual Return will exceed the given rate with indicated probabilities

■ **Fresh Starts:**

- **30 Year Fresh Start for 06/07**
- 15 Year +0.4% 20 Year +0.2% 25 Year +0.1%

■ **No Other:**

- Gains or Losses
- Method or Assumption Changes
- Benefit Improvements

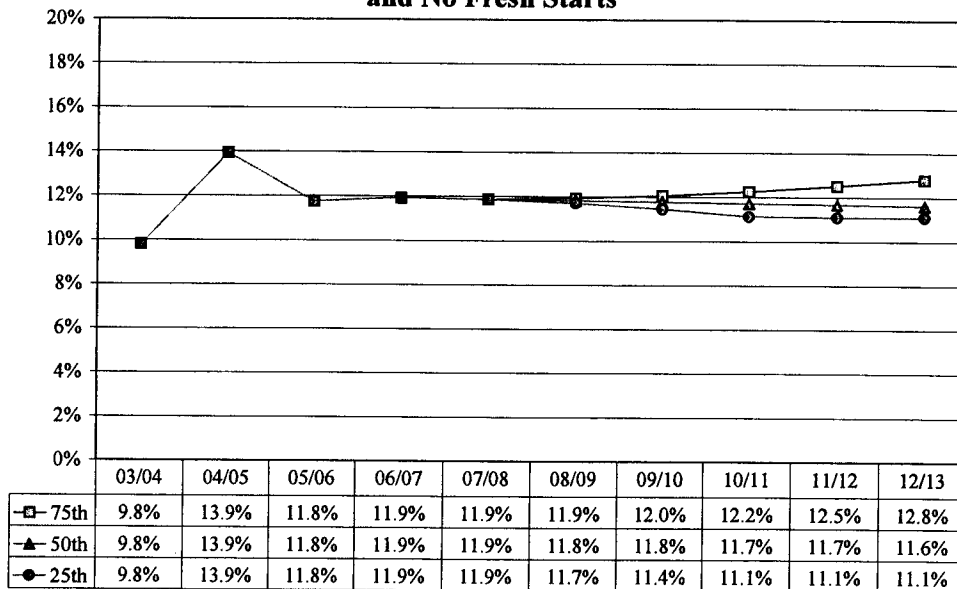


Revised 5/3/06



Contribution Rates Miscellaneous

Investment Return Varies and No Fresh Starts



Revised 5/3/06



Contribution Rates Miscellaneous

- **Market Value Investment Return:**
 - June 30, 2005 12.3%
 - June 30, 2006 - 2010 75% Confidence Limit*: ≈ 2.6%
 - 50% Confidence Limit: ≈ 7.75%
 - 25% Confidence Limit: ≈ 12.9%

*Confidence Limits – Actual Return will exceed the given rate with indicated probabilities

- **Pension Obligation Bond (POB):**
 - **Includes Debt Service on POB**
- **No Other:**
 - Gains or Losses
 - Method or Assumption Changes
 - Benefit Improvements

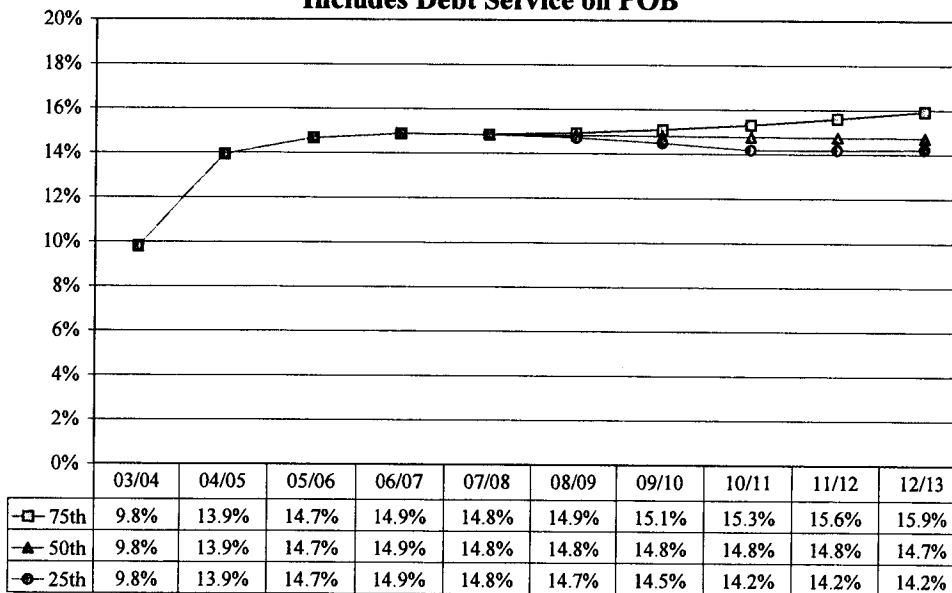


Revised 5/3/06



Contribution Rates Miscellaneous

Investment Return Varies Includes Debt Service on POB



Revised 5/3/06



POB (Millions)
CalPERS Proceeds Estimated Balance

	<u>Safety</u>	<u>Miscellaneous</u>	<u>Total</u>
■ POB @ 2/16/05	\$85.7	\$311.2	\$396.9
■ Earnings to 6/30/05 ¹	3.8	13.8	17.6
■ Amort. Payment through 6/30/05 ²	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
■ Balance @ 6/30/05	89.5	325.0	414.5
■ Earnings to 2/15/06 ³	9.3	33.6	42.9
■ Amort. Payment through 2/15/06 ⁴	<u>(3.4)</u>	<u>(12.2)</u>	<u>(15.6)</u>
■ Balance @ 2/15/06	95.4	346.4	441.8

¹ Estimated based on CalPERS 6/30/05 12.2% Market Value return from 2/16/05 through 6/30/05.

² CalPERS 6/30/04 reports show no reduction in 04/05 contribution.

³ Estimated based on CalPERS 3/31/05 11.0% Market Value return from 6/30/05 through 3/31/06.

⁴ Based on a fixed 30-year amortization



Revised 5/3/06



POB (Millions)
Bond Proceeds Balance

	<u>Payments</u>			<u>Balance</u>
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	
■ 2/17/05	n/a	n/a	n/a	\$ 400.0
■ 8/15/05	n/a	\$ 9.4	\$ 9.4	400.0
■ 2/15/06	\$ 3.2	9.5	12.7	<u>\$ 396.8</u>



Revised 5/3/06



POB (Millions)
Net Estimated Savings

■ Net Estimated Savings:	
A. CalPERS Estimated Balance	\$ 441.8
B. Bond Proceeds Balance	396.8
C. Cash Flow Savings/(Deficit) [Payments that would be paid to CalPERS less POB debt service]	<u>(6.5)</u>
D. Net [(A) – (B) + (C)]	38.5
■ Net Estimated Savings:	
E. CalPERS Investment Earnings	\$ 60.5
F. POB Interest Payments	18.9
G. Cost of Issuance	<u>3.1</u>
H. Net [(E) – (F) – (G)]	38.5
■ Above estimates based on market rate of return. Savings based on actuarial rate of return would be lower.	



Revised 5/3/06



POB (Millions)
Net Estimated Savings
This Page Intentionally Blank.



Revised 5/3/06



CalPERS Rating Smoothing

	Old Method	New Method
6/30/2003:		
Market Value	100.00	100.00
Actuarial Value	110.0	110.0
6/30/2004:	16.57%	16.57%
Market Value	116.6	116.6
Actuarial Value:		
1. Project @ 7.75%	118.5	118.5
2. Adjust: [(MV-AV) x (old: 1/3; New: 1/15)]	117.9	118.4
3. Limited by corridor	117.9	118.4
Actuarial Rate of Return	7.2%	7.6%
Ratio of Actuarial Value to Market Value	101.1%	101.6%



Revised 5/3/06



CalPERS Rating Smoothing

	Old Method	New Method
Actuarial Asset Values		
● Project Assets forward	7.75%	7.75%
● Asset Gain/Losses Recognized	3 Years	15 Years
● Ratio of Actuarial to Market Value of Assets	90-110%	80-120%
Actuarial Asset Methods		
● Amortization		
○ Years	12.7 Years	30 Years
○ Factor	10%	6%
● Minimum	None	Normal Cost less 30 Year Amortization of Surplus



Revised 5/3/06



APPENDIX 2
New York Times Article
“Japanese Cars, American Retirees”

May 19, 2006

Japanese Cars, American Retirees

By EDUARDO PORTER

GEORGETOWN, Ky. — For the last quarter-century, Toyota, Honda and Nissan have strived to appear to American consumers like homegrown companies.

They built a string of manufacturing plants in the South, employing tens of thousands of local workers. They hired American designers. They spent millions on ads to trumpet their growing roots in communities across the country.

"Being a good corporate citizen starts with hiring lots of good citizens," one Toyota ad says.

Yet as they built up their operations, the Japanese "transplants" have worked hard not to resemble an American car company in one vital respect: how they treat their retirees.

"We want to avoid commitments when we have no control over their costs," said Pete Gritton, the head of human resources for Toyota's United States manufacturing operations. "We can't build in things in such a way that we won't be able to keep our commitments later."

Until recently, the issue has mostly been academic for the Japanese car companies. Most of the American factory workers they started hiring in the mid-1980's are still working.

But age is creeping up on them. All three Japanese companies are anticipating that the ranks of retirees will swell over the next several years. Toyota's American arm, for example, has just 258 retired production workers (G.M., by contrast, has more than 400,000 retirees).

But things will change over the next five years. In 2011 and 2012, a combined 1,700 workers will be eligible for retirement at Toyota — about 6 percent of its current labor force.

Their retirement will contrast in a crucial way with their counterparts who have retired from the Big Three auto companies in that they will bear much more of the costs and the risks of retirement on their own.

This difference adds up to an important cost disadvantage for the Big Three as they fight to regain market share.

The benefit packages offered by Detroit's three carmakers to its blue-collar workers, negotiated over time with the United Automobile Workers union, pretty much fit a standard model. Retirees receive a pension check every month, which varies with the number of years served.

An average worker who reaches retirement age at G.M. will get a monthly pension check worth about \$50 for every year of service, up to a maximum of about \$1,500 a month, which accrues after 30 years of service, according to a G.M. spokesman, Jerry Dubrowski. Retirees with 30 years of service get a supplement that brings their monthly check up to about \$3,000 until they reach 62.

Moreover, until last year, when General Motors and the union cut a deal for retirees to cover co-pays and deductibles, G.M. covered retirees' health care expenses.

With benefits like these, it's no wonder that G.M. was once known as "Generous Motors."

But these days, health care costs are causing enormous financial headaches for the Big Three. G.M. has an unfunded liability of \$85 billion in today's money to cover future health care costs for workers and retirees. That is seven to eight times the market value of the whole company.

General Motors estimates that health care costs add about \$1,500 to the cost of each vehicle it makes in the United States. Chrysler claims a health care cost of \$1,400 per vehicle. Ford says its burden is \$1,100.

G.M.'s pension plan has also been a drain. Since 1992, G.M. has plowed \$56 billion in stock and cash into it. It is hoping to reduce its burden by offering all of its 105,000 U.A.W. workers buyout packages worth up to \$140,000. It is still unclear how many plan to accept the offer.

"The higher legacy costs are reflected in a less modern product," said George E. Hoffer, a professor of economics at Virginia Commonwealth University who has studied the auto industry. "They had to cut costs somewhere else and they cut costs in retooling."

Japanese companies face little of this burden in Japan, where the government covers retirees' health care and pays a bigger share of

workers' pensions.

Toyota expected to pay out about \$700 million in pension benefits in fiscal year 2006, which ended in March. That's less than a tenth of what G.M. expects to pay on its pensions this year.

In the United States, retirees of the Japanese companies pay part of their health care costs. And the Japanese companies' pension obligations are a fraction of that of the American carmakers.

While G.M. paid \$5.4 billion last year for the health care of its 141,000 workers, 449,000 retirees and their dependents, Toyota said in its 2005 annual report that its obligations to cover the health care expenses for its retirees "are not material."

At Honda, a 60-year-old retiree with 10 years of service would typically pay \$345 a month for health care; a 62-year-old retiree with 25 years at the company would pay \$70. Toyota also requires retirees to pay part of their premiums, based on years of service.

In general, these retirees are cut off from the company health plan when they turn 65, and receive instead a lump sum with which they can buy supplementary insurance to Medicare. Honda is alone among the big three Japanese carmakers to still offer a defined-benefit pension guaranteeing a monthly check to newly retired workers in the United States.

At Toyota, a worker's pension consists of an investment account in which the company deposits the equivalent of 5 percent of a worker's earnings each year, typically around \$3,000 to \$3,500. An employee can supplement that with a 401(k) plan, and the company matches contributions up to a maximum of 4 percent of the worker's income.

For the company, these retirement packages carry no uncertainty. But they do for workers, whose nest eggs depend on their contributions and the financial markets.

Consider Richard Baugh. The 61-year-old worker, who applies sealant on Camrys, Solaras and Avalons in the paint room, is planning to retire next January after 17 years at Toyota's factory here, to tend his horses and teach at his local church in nearby Cynthiana.

His wife, Ruth, 58, will also retire after 14 years at the plant. With total savings of some \$700,000, the Baughs feel ready for retirement. They were thrifty, plowing at least 12 percent of their wages into their 401(k)'s.

"After the stock market crash we stayed invested and kept buying, and our 401(k) roared back," Mr. Baugh said.

With less than 25 years at the company, they will have to pay a portion of their health insurance premium, which Mr. Baugh said would amount to some \$300 a month.

Tim Garrett, vice president of administration at Honda Manufacturing of America, says talk of the Big Three's "legacy" problem is overblown. Had they set enough money aside when the workers were active, their retirement would not be costing them anything today. "Depending on your decisions you will have legacy costs or you will not have legacy costs," Mr. Garrett said. "We have no legacy costs."

To be fair, Detroit's car companies were no more shortsighted than many companies in other industries. From steelmakers to telephone companies, free health and defined pension checks were a staple of the retirement packages negotiated between America's industrial titans and their unions half a century ago.

When these companies were growing quickly, providing generous retirement benefits seemed cheaper than offering better pay, a future cost that often did not even have to be accounted for on the financial books.

From 1990 to 2005, G.M.'s payroll shrank by two-thirds, and its current work force is now just one-third the number of its retirees and their dependents.

Today, defined-benefit pensions are dwindling across industries, as companies force retirees and active workers to pick up part of their health costs. According to a survey by the Kaiser Family Foundation, only one out of three big companies now provide health care coverage for their retirees, down from two-thirds in 1988.

In 2003, 22 million workers were covered by some sort of defined-benefit pension, 8 million fewer than in 1980, according to the Center for Retirement Research at Boston College. And the number of workers in defined-contribution plans jumped to 52 million, from 14.5 million, over the same period.

Union contracts have limited what Detroit's car companies can do with their blue-collar workers, but they are paring back where they can.

G.M. eliminated health care coverage for its salaried, nonunion retirees hired after 1993. This year, it froze the salaried workers' defined-contribution pension plan. Chrysler made its salaried workers pay more for their health care starting this year.

Under an agreement last year with the autoworkers' union, retirees at G.M. and Ford will start paying part of their health care costs,

up to \$370 a year for an individual and \$752 for a retiree's family.

With Detroit sagging under the burden of these "legacy" costs, it is unsurprising — even to executives at the Big Three — that the Japanese companies arriving in America chose to do things differently.

"These are well-managed companies," said Frederick A. Henderson, G.M.'s chief financial officer. "It is natural that they would look at our experience and say 'I don't want to do that.'"

Copyright 2006 The New York Times Company

[Privacy Policy](#) | [Search](#) | [Corrections](#) | [XML](#) | [Help](#) | [Contact Us](#) | [Work for Us](#) | [Site Map](#)

APPENDIX 3
USA Today Article
“Retiree Benefits grow into ‘monster’ ”

Retiree benefits grow into 'monster'

USA TODAY.com

By Dennis Cauchon, USA TODAY

Thu May 25, 7:40 AM ET

Taxpayers owe more than a half-million dollars per household for financial promises made by government, mostly to cover the cost of retirement benefits for baby boomers, a USA TODAY analysis shows.

Federal, state and local governments have added nearly \$10 trillion to taxpayer liabilities in the past two years, bringing the total of government's unfunded obligations to an unprecedented \$57.8 trillion.

That is the equivalent of a \$510,678 credit card debt for every American household. Payments on this delinquent tax bill must start soon if financial promises to the elderly are to be kept.

The cost of retirement programs will start to soar when baby boomers - 79 million born between 1946 and 1964 - begin collecting Social Security in 2008 and Medicare in 2011.

"This is a monster financial problem that both parties are going to have to solve," says Rep. Jim Cooper (news, bio, voting record), D-Tenn., a member of the House Budget Committee. "Most Americans and Congress members don't realize the terrific burden we are putting on future generations."

USA TODAY compiled a list of all taxpayer liabilities - federal, state and local - to provide a fuller look at the nation's financial condition. The numbers are based on official government reports.

Americans' government obligations are five times what people owe for mortgages, car loans, credit cards and other personal debt. The \$57.8 trillion liability is the amount that government needs now, stashed away and earning interest, to generate enough cash to pay future obligations. The obligations are valued in today's dollars and come due as early as in a few days, when Treasury bills mature, to as long as 75 years for Social Security and Medicare.

Like an unpaid credit card bill, the balance grows every year - about \$25,000 per household annually.

Taxpayer liabilities grew 20% in the past two years, 13% above the inflation rate.

What's behind the increase:

- Medicare. The health care program for the elderly saw its long-term deficit grow \$4.5 trillion from 2004. The causes: higher medical costs and an aging population. Not a factor: the new Medicare prescription drug benefit. It was included in the 2004 number.
- Social Security. The program's deficit for workers and beneficiaries already in the system grew \$2.5 trillion over two years. Reason: Each generation gets benefits greater than the last, so the program automatically gets more out of balance every year.
- Government retirement benefits. Pension and retiree medical benefits for civil servants and military personnel are more generous than those for private-sector workers. But government has not set aside as much money as private companies to pay the costs.

"These numbers show our long-term financial problems are even greater than our short-term ones," says Ed Lorenzen, policy director at the Concord Coalition, which promotes fiscal responsibility.

Economist Dean Baker of the liberal Center for Economic Policy Research says the nation can afford Social Security but not the current health care system. "If we don't fix health care, it's hard to imagine what our country looks like in 20 years," he says.

Copyright © 2006 USA TODAY, a division of Gannett Co. Inc.

Copyright © 2006 Yahoo! Inc. All rights reserved.

Questions or Comments

[Privacy Policy](#) - [Terms of Service](#) - [Copyright/IP Policy](#) - [Ad Feedback](#)