

ATTACHMENT B
STAFF'S ARGUMENT

STAFF'S ARGUMENT TO ADOPT THE PROPOSED DECISION

The issue in this case is whether CalPERS erred when it determined that Respondent City of San Carlos' (Respondent City) Inactive Safety Police Plan must be unwound from consolidation with the Active Safety Fire Plan in the "2% at 50" risk pool. When CalPERS notified Respondent City of its decision to remove the Inactive Safety Police Plan members from the "2% at 50" risk pool (Risk Pool #7), the City's inactive members were placed in the Inactive Plan Pool (Risk Pool #10). Respondent City appealed, and a hearing was completed on September 24, 2013.

Respondent City provides police and fire protection to its residents. On October 31, 2010, Respondent City eliminated its police department and "outsourced" its police services to the San Mateo County Sheriff's office. The City's police plan became inactive, and the June 2011 actuarial valuation moved the inactive police plan to Risk Pool #10, the Inactive Plan Pool.

In the Summer of 2011, Respondent City requested to consolidate the City's Inactive Safety Plan with its Active Safety Fire Plan, in Risk Pool #7. Respondent City was faced with increased costs, and expected to save about \$800,000 annually if allowed to consolidate. CalPERS initially allowed consolidation, effective June 2012.

About four months after consolidation was permitted, CalPERS reviewed the numbers for the June 30, 2011, valuation of Risk Pool #7. CalPERS determined that the consolidation materially increased the contribution rate for all employers in Risk Pool #7.

In October 2012, CalPERS called and wrote Respondent City to explain that the consolidation would be reversed due to increased costs to all other participating employers in Risk Pool #7. The result of the total projected additional contributions required of other employers in Risk Pool #7 was approximately \$375,000 annually or \$18,000,000 over 30 years (later analysis lowered the increased cost estimate to approximately \$14,500,000). Respondent City objected to unwinding the consolidation, and filed an appeal of CalPERS determination.

At hearing, Chief Actuary Alan Milligan provided testimony regarding the implementation of risk pooling, the active/inactive risk pools, the fiduciary impact to other employers, and his authority as delegated by the Board. Mr. Milligan testified that leaving the consolidation alone would result in increased costs to Risk Pool #7 of approximately \$14.5 million. This was a material difference which needed to be corrected under Government Code section 20160. Mr. Milligan testified that CalPERS should have kept the Inactive Safety Police Plan in Risk Pool #10, and should have properly analyzed the financial impact on other employers prior to informing the City that it would allow consolidation.

Respondent City argued that CalPERS should allow all safety members to participate in the same risk pool regardless of whether they were active or inactive. Respondent City also argued that CalPERS failed to demonstrate that the inclusion of the inactive with active safety members had a material impact on other employers in Risk Pool #7.

Respondent City argued that the increased contributions from other participating employers was not enough to warrant excluding the inactive safety members from Risk Pool #7, and that unwinding of the consolidation was an arbitrary decision.

The Administrative Law Judge (ALJ) found that Respondent's contention that CalPERS had acted arbitrarily was without merit. The ALJ found that it is within CalPERS' power to exclusively control and manage the retirement fund, and determine the conditions under which people may continue to receive benefits. The ALJ also found that Mr. Milligan was authorized to ensure that the California Public Employees' Retirement Law, regulations and policies are properly implemented. Mr. Milligan's authority includes the authority to determine that an employer's participation in a risk pool has an unacceptable material impact on other employers in that pool.

The ALJ found that the consolidation initially allowed by CalPERS should not be permitted to stand. The ALJ agreed with Mr. Milligan that the consolidation contravened the Board's policy, as set forth in its Resolutions regarding Risk Pooling, of placing members in risk pools based on their active or inactive status. The ALJ also agreed that the placement of Respondent City's inactive police members in a risk pool with active members had an unacceptable material impact on other employers participating in the active risk pool. The ALJ found that CalPERS' correction of the improper consolidation was required by statute and proper.

The ALJ held that CalPERS established that its consolidation of the inactive and active safety members into Risk Pool #7 was an error, because it violated the Board's Resolutions, and because the consolidation materially impacted the other employers in Risk Pool #7. CalPERS owes a duty to each of the participants in Risk Pool #7 to minimize employer contributions. If CalPERS allowed this consolidation to stand, it would benefit Respondent City at the expense of the 68 other employers in Risk Pool #7.

The ALJ held that CalPERS was authorized, and indeed required to, correct its mistake. To hold otherwise would abrogate the fiduciary obligations owed by CalPERS to all its members.

The ALJ concluded that Respondent City's appeal should be denied. The Proposed Decision is supported by the law and the facts. Staff argues that the Board adopt the Proposed Decision.

Because the Proposed Decision applies the law to the salient facts of this case, the risks of adopting the Proposed Decision are minimal. The City may file a Writ Petition in Superior Court seeking to overturn the Decision of the Board.

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