Finance and Administration Committee

Agenda Item 7b

September 20, 2016

Item Name: Public Agency Contracts Review

Program: Financial Office

Item Type: Information

Executive Summary

This information item is provided to update the Finance and Administration Committee ("FAC") on the status of three contracting agencies that are significantly delinquent in payment of obligations to the California Public Employees' Retirement System ("CalPERS" or "System"). These agencies include one terminated agency, the City of Loyalton ("Loyalton"), and two inactive but not yet terminated agencies, the California Fairs Financing Authority ("CFFA") and the Niland Sanitary District ("Niland").

Staff's efforts to collect delinquent amounts owed to CalPERS have been ongoing for a prolonged time period. However, to date these agencies have not paid the amounts owed to CalPERS. As a result, on August 31, 2016, a final demand letter was sent to each agency. The letters provide the agencies 30 days to bring their accounts current. If the 30 days pass without full payment, staff will initiate termination proceedings under Government Code § 20572 and seek the Board's approval to terminate the contracts of Niland and CFFA. Although Loyalton voluntarily terminated its contract in March 2013, it has not paid the termination liability. If Loyalton does not pay the amount owed, the Board will be asked to declare Loyalton in default under Government Code section 20577. For all three agencies, failure to pay the termination liabilities required by the contracts will result in a reduction of retirement benefits under Government Code § 20577.

Staff anticipates that it will bring Agenda Items to the FAC addressing each of these three cases in November. The purpose of today's Agenda Item is to inform the FAC in advance of these potential recommendations.

Strategic Plan

The Agenda item supports Goal A of the CalPERS 2012-17 Strategic Plan, which aims to improve long-term pension and health benefit sustainability. Pension and health benefit funding are considered a strategic risk to the organization, and proper management of employer contracts and collection of payments are critical to ensuring the long-term sustainability of the System.

Background

The Public Employees' Retirement Fund ("PERF") is a trust that holds and invests the assets needed to pay retirement benefits that participating agencies have agreed to provide to their employees. The California Constitution and state statutes define the trust relationship and the rights and duties of the Board, the public agencies, and the members of the System. The CalPERS Board has the fiduciary duty to ensure the integrity of the System in order to pay benefits. CalPERS does not have the authority to forgive employer contributions that are necessary to sustain the soundness of the System.

When a public agency voluntarily chooses to provide retirement benefits to its employees at various levels (*e.g.*, 3% at 50, 2% at 55) through the System, the public agency contracts with CalPERS and agrees to be bound by the statutory provisions governing the System. This includes agreeing to make its eligible employees members of the System and to timely pay required contributions. Employer contribution rates are determined by periodic actuarial valuations in accordance with state law. Actuarial valuations are based, in part, on the benefit formulas the agency has adopted and the employee groups covered.

Participating public agencies may voluntarily terminate their relationship with CalPERS. However, termination of this relationship does not terminate the public agency's obligations to pay required contributions to CalPERS to fund benefits accrued prior to termination. Instead, state law provides for a valuation of the assets and the liabilities of the employer at the time of termination. Because termination of the relationship effectively closes the pension plan for that employer, any unfunded liabilities as of the effective date of termination must be fully paid by the employer.

State law also provides for the involuntary termination of public agency contracts. Specifically, Government Code § 20572 sets forth the provisions governing involuntary terminations and provides the Board the authority, by resolution adopted by a majority vote, to terminate the contract if:

- The contracting agency fails to pay any installment of required contributions for 30 days after a demand for payment; or
- The contracting agency fails to provide information with respect to that agency's employees required for the administration of the system for three months after a demand for the information; or
- CalPERS determines that the agency no longer exists.

Moreover, Government Code § 20577 requires the Board to reduce member benefits in proportion to the amount of the employer's deficiency in paying the required contributions. In limited situations, when a deficiency exists, § 20577.5 allows the Board to merge a terminated plan into the Terminated Agency Pool ("TAP") without benefit reduction or with a lesser reduction if the Board has made all reasonable efforts to collect the amount necessary to fully fund the liabilities of the plan and if the Board finds that the merger of the plan into the TAP without benefit reduction would not impact the TAP's actuarial soundness. The Board has delegated this determination to the General Counsel (reasonable efforts to collect) and the Chief Actuary (impact on the TAP's actuarial soundness).

In order to most effectively carry out its responsibilities under the laws cited above, Staff has initiated a multi-pronged approach to enhance employer contract management including the following:

- Implementation of rigorous underwriting and due diligence standards prior to contracting with new employers that desire to enter the system;
- Enhancement of collections processes;

- Increased engagement with employers regarding education and account status support;
- Initiation of employer financial analysis to monitor employer capacity to fund pension obligations; and
- Exploration of additional mitigation strategies for employer plans to enter the TAP.

Analysis

Employer pension accounts receivable are considered delinquent when payments have not been received within 30 days of the due date. Employer health receivables are considered delinquent when payments have not been received by the 10th of the month. When a payment is late, delinquency notices are sent in 30-day intervals and interest is assessed until the receivable is paid.

Niland, Loyalton and CFFA are significantly delinquent on the amounts due to the System. The Financial Office ("FINO") has performed a detailed escalation process and conducted extensive research to ensure the accuracy and escalated engagement to provide every reasonable opportunity to these agencies to facilitate payment of the funds due to the System. These efforts have not been successful and the last recourse is to send the Final Demand Letters. The table below summarizes the amounts owed to CalPERS:

	*Amounts Owed to CalPERS in $ Report Date: 9/1/16				
Name	Arrears	Accrued Unfunded Liability	GASB Reporting Fees	Termination Costs	Total
Niland	21,562	583	1,650		23,795
CFFA		359,658	1,300		360,958
Loyalton				1,661,897	1,661,897

*In addition to the amounts owed above, termination costs for Niland and CFFA would be calculated at the effective date of termination.

After several unsuccessful attempts (including numerous letters and calls) by staff to collect the contributions owed by each of the agencies, a final demand letter was sent by certified mail to each agency on August 31, 2016. These letters give the agencies 30 days to bring their accounts current. If the 30 days pass without full payment, staff will initiate termination proceedings under Government Code section § 20572 and seek the Board's approval to terminate the contracts of Niland and CFFA. Loyalton voluntarily terminated its contract in March 2013. For all three agencies, failure to pay the termination liabilities required by the contracts will result in a reduction of retirement benefits under Government Code § 20577.

If Niland and CFFA fail to make the required payments, staff will bring agenda items to the FAC in November asking for the adoption of a resolution that would terminate the contract of each agency, which would be effective 60 days after mailing of the notice of termination. The November agenda items will describe in detail staff's attempts to collect the delinquent contributions and provide the estimated amount of the benefit reductions to the members.

Budget and Fiscal Impacts
This is an information item and does not create any budget of fiscal impact at this time.

Benefits and Risks
Moving forward with the referenced contract terminations and potential reductions in retiree pension benefits entails certain benefits and risks.

Benefits include:

- Fulfills CalPERS fiduciary obligations through strengthening the long-term sustainability of the System.

Risks include:

- Benefit reductions could trigger potential litigation.

Attachments
Attachment 1 – Employer Demand Letters
Attachment 2 – Member Notifications

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