CalPERS

Board of Administration
Agenda Item 8

November 16, 2016

Item Name: Delinquent Contracting Agencies Matter

Program: Pension Contract Management Services

Item Type: Action

Recommendation
Staff recommends the Board of Administration ("Board") declare the City of Loyalton ("Loyalton" or "City") in default of its obligations to California Public Employees' Retirement System ("CalPERS" or "System"), and reduce the retirement benefits to be paid to Loyalton's employees and retirees in accordance with Government Code section 20577.

Executive Summary
At the September 2016 meeting of the Finance and Administration Committee ("FAC"), staff presented an update on contracting agencies significantly delinquent in the payment of obligations to the System. These agencies include one terminated agency, the City of Loyalton, and two delinquent but not yet terminated agencies, the California Fairs Financing Authority ("CFFA") and the Niland Sanitary District ("Niland"). Included in this agenda item are updates on actions taken by CFFA and Niland to avoid initiation of involuntary termination proceedings under Government Code section 20572, and staff's recommendation to declare Loyalton in default and reduce retirement benefits under Loyalton's contract in accordance with Government Code section 20577.

Strategic Plan
This Agenda item supports Goal A of the CalPERS 2012-17 Strategic Plan, which aims to improve long-term pension and health benefit sustainability.

Background
<u>CFFA</u>
In response to CalPERS' collection efforts, CFFA met with staff on October 5, 2016 and made a significant payment on its delinquent balance. CFFA has acted promptly to bring its account current and resolve the delinquent amounts owed to CalPERS, ensuring the remaining delinquent amounts, plus interest, will be fully current by June 30, 2017.

<u>Niland</u>
As reported at the September FAC meeting, staff sent a final demand letter to Niland on August 31, 2016, giving the agency 30 days to bring its account current or staff would initiate termination proceedings under Government Code section 20572. However, Niland recently informed staff that it completed the voluntarily termination process under section 20570. Niland provided its termination documents to CalPERS on November 1, 2016.

A participating public agency may voluntarily terminate its relationship with CalPERS. However, termination of this relationship does not end the agency's obligations to pay CalPERS the amount necessary to fund accrued benefits prior to 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 to avoid a benefit reduction.

As part of the voluntary termination process, next steps include the Office of Audit Services ("OFAS") performing a final audit of Niland and for the Actuarial Office ("ACTO") to perform a final valuation and determine Niland's termination liability. Please note that since October 31, 2013 Niland has reported to CalPERS that it has no active employees. However, recent discussions with Niland lead staff to believe that Niland may presently have active employees who should have been reported to CalPERS. The final audit will be used to ensure that ACTO has accurate and complete data to calculate the final termination valuation.

Loyalton

Loyalton contracted with CalPERS for pension benefits beginning in January 1986. In September 2004, Loyalton amended its contract to provide its employees the current benefit formula of 2.7% at 55. The City terminated its contract with an effective date of March 31, 2013. On June 10, 2014, CalPERS provided the City with an invoice for the termination liability in the amount of $1,661,897. Subsequent to the invoice, staff has had multiple discussions with Loyalton regarding the termination process, accuracy of the final valuation, the City's ability to rescind the termination, and whether it could establish a new contract. Staff addressed the City's questions and followed up with a final collections letter on December 15, 2015.

Subsequent to the final collection letter, Loyalton reiterated the same concerns that staff previously addressed. Staff again addressed these concerns and determined them to be unfounded. Staff resumed collection efforts and, to date, Loyalton has not made any payments toward its voluntary termination costs. In total, staff's ongoing collection efforts and addressing concerns from Loyalton have resulted in over 50 telephone calls and 10 collection notices to the City.

On August 31, 2016 staff sent a "Final Demand Letter" to Loyalton demanding the City bring its account current within 30 days or be declared in default. In addition, a certified letter pursuant to Government Code section 20577 was sent to the affected members to advise them of CalPERS' proposed action to reduce benefits. The 30 days have passed, and the City has not paid the amount owed to CalPERS. A meeting with Loyalton's counsel on October 31, 2016 did not lead to a payment resolution.

Government Code section 20577 provides that if an agency fails to pay the full amount of the termination valuation, the Board can declare the agency in default and consequently reduce member retirement benefits from the date of contract termination in proportion to the amount of the employer's deficiency in paying its required contributions. Staff has exhausted all reasonable efforts to collect from the City the amounts owed, including giving the City multiple opportunities to bring its account current. Because the City has failed to make any payment towards its termination liability, staff recommends that the Board declare the City in default in accordance with section 20577. As discussed, this will result in a reduction in benefits to Loyalton's employees and retirees. Further notice will be provided to affected employees and retirees of benefit reductions effective for the following pay period.

While a final calculation of the unfunded liability will be made by ACTO as of the date of actual benefit reductions, this table indicates that the City was only 39.5% funded as of March 31, 2013, indicating that a substantial reduction in retirement benefits that were based on a 2.7% at 55 formula can be expected.

Termination Cost		**Employees/Retirees Impacted**		
Termination Unfunded Accrued Liability	Funded %	Active Members	Retirees	Separated not yet retired
1,661,897	39.5%	0	4	1

In very limited situations regarding involuntary terminations, when a deficiency (unfunded accrued liability) exists, section 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). However, Loyalton is not eligible to be evaluated under section 20577.5 as this section does not apply to voluntary terminations.

Budget and Fiscal Impacts
Eliminating the outstanding liabilities of Loyalton, and, therefore, its unfunded liability, through the reduction in benefits will improve the overall funding ratio of the System.

Benefits and Risks
CalPERS is charged with administering the System in accordance with the law. Enforcing the provisions of the contract and the statutes with respect to contract terminations and resulting benefit reductions, when appropriate, helps ensure that employers contracting with CalPERS comply with the statutory provisions governing the System. This includes agreeing to make its eligible employees members of the System and to timely pay required contributions as well as on termination to fund benefits accrued prior to termination. The CalPERS Board has a fiduciary duty to ensure the integrity of the System in order to pay benefits and to protect the soundness of the System when employers do not pay their required contributions to CalPERS.

Other contracted agencies are not impacted by the voluntary termination of Loyalton, the benefits of the four retirees and one separated employee as members of the Loyalton plan will be impacted by a benefit reduction. There is a risk that the benefit reductions could trigger potential litigation by employees against their employer that could require CalPERS' involvement.

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