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PUBLIC RETIREMENT PLANS

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Panelists: THOMAS P. BLEAKNEY
DREW ANTHONY JAMES
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Recorder: RICHARD O. GOEHRING

The panel will discuss the latest developments in the governmental plan sector including:

- Regulatory trends
- Funding requirements
- Benefit trends
- Pressures on assumptions
- Qualifications
- The effect of Internal Revenue Code (IRC) limits

MR. RICHARD O. GOEHRING: I'm with the C&B Consulting Group out of Ft. Lauderdale, Florida. I will introduce our distinguished panelists. Drew James is a Fellow of the Society of Actuaries. He also is with the C&B Consulting Group in the San Francisco office. Drew spends the majority of his time consulting on public plan issues. Drew will be focusing on nondiscrimination and qualification issues, as well as Section 415 limits. Specifically within that context, he will be alluding to a study that he performed for the Public Employee Retirement System of California.

Tom Bleakney probably needs no introduction to most of you. Tom is also a Fellow of the Society. He's a consulting actuary with Milliman and Robertson in Seattle. Tom now spends 100% of his time in the public arena. Tom, as you may know, has authored a book on public plans, which has been around for quite a while, and he tells me it's still on the syllabus, as well as a study note, which I guess updates some of the material in the book. The book is *Retirement Systems for Public Employees*. Tom will be discussing funding requirements and specifically the status of the Governmental Accounting Standards Board (GASB) expense requirements, benefit trends and pressures on assumptions.

Last is Pat Wiegert. Pat is with the Contra Costa County Employees' Retirement Association. Pat is a Certified Employee Benefit Specialist. She's currently a Retirement Administrator with the county, as I mentioned. She's been in that position for two years. Previously she served for the Public Retirement System in Oregon for four years and prior to that with the system in Wisconsin for 17 years. Pat will also be talking about benefit trends and pressures on assumptions, but I hope her vantage point of working for a system will give us some additional perspective that we otherwise might not get in our roles as consulting actuaries.

* Ms. Wiegert, not a member of the sponsoring organizations, is Retirement Administrator of Contra Costa County Employees' Retirement Association in Concord, California.

MR. DREW ANTHONY JAMES: I'm going to talk about the general qualification issues as they relate to public plans, specifically with regard to nondiscrimination and Section 415.

As most of you probably know, before the 1986 Tax Reform Act the issue of qualification and public plans was pretty much a dormant issue. The reason for that was the IRS really didn't have any clear position. In the late 1970s, the IRS attempted to assert its position that Section 115, the general exemption for income tax for government entities, did not apply to public retirement funds. There was a huge public outcry as a result of that. The IRS backed off by issuing the now famous Information Release (IR) 1869. Essentially, what that said is that the IRS would not raise issues with respect to nondiscrimination nor the taxation of public pension trusts until a further study was carried out. Now, that study was never carried out, but the story went on.

One thing to keep in mind here is that not all qualification issues were addressed by that particular information release. It just had to do with nondiscrimination, specifically with regard to elected and appointed officials and taxation of public plan trusts. There was a 1978 report from the House Committee on Education and Labor which concluded that IR-1869 should apply to all qualification issues and that the IRS would not raise any issues with public plans until further notice. As a result of those events, there was very little risk in public plans essentially going their merry way and designing their benefits without regard to Social Security integration, without regard to Section 415 limits and so forth, so that's exactly what happened.

Then in 1986 the Tax Reform Act reopened the door of qualification issues. There were special 415 limits that were enacted as part of that legislation. Section 401(l) and 401(a)(26) were applicable to public plans. Then following that, in 1989 we had the withdrawal of the IR-1869 and with that the insulation from nondiscrimination issues was gone. The taxation of public plan funds was thrown back up into the air, and that's pretty much where we find ourselves here today. We've got regulations that are coming out and we need to determine whether we need to comply with them and how we comply with them. It's turned out to be a very difficult exercise.

The applicability of federal tax law to state and local government plans is not just complicated by the lack of IRS guidance. It's really subsumed in the more deep legal issues of federalism and state's rights. An example of this came about when the 1986 Tax Reform Act instituted the new 415 limits, or I should say reasserted the 415 limits for public plans, and what happened is that these plans had been designed without 415 limits imposed on them. Now, in certain states there are constitutional protections against reductions in benefits, and we're not talking accrued benefits in the ERISA sense. What we're talking about is not only accrued benefits, but also the right to accrue future benefits based under a specific plan formula. That particular right attaches with the employment contract. It's contract law.

Now, this produced a catch-22 situation. Either you can go ahead and pay the benefits out without regard to 415 limits, in which case you're risking disqualification of the plan potentially, or you can impose the 415 limit and run afoul of the state constitutional protections on anticutback. As a result of that catch-22, the Section 415(b)(10) election was instituted as part of the Technical and Miscellaneous Revenue

Act (TAMRA) in 1988, and therefore there was at least some way to deal with that. It may not be a very good one, but it was a way to deal with it.

Now, the more basic issue is yet to be resolved, and that is the federal government's right to impose its rules on the relationship between state and local governments and their employees. That is the concept of federalism itself. However, if you step back from those deep legal issues, it's pretty clear that the public plan participants are enjoying the benefits that are generally reserved for participants of qualified plans; for example, the special tax treatment of distributions, the right to roll over benefits, deferral of taxes until the distribution of those benefits, the pretax contributions available under 414(h)(2) and also the fact that the public plan funds are not paying taxes on their income. It begs the question of why not apply the same qualification rules. Well, the problem is that these plans are indeed very different than private plans.

Number one, there are no deductions that are taken by these public employers with regard to the contributions that they're making. The real beneficiaries of the tax advantage are the plan participants themselves. They're the ones who are really enjoying most of the advantages. If disqualification were to occur, it would really be the plan participants who would suffer. Now, I guess you can make some argument that, if disqualification were to occur, there may be pressure on public employers to make good on the benefits that they promised, including the lost tax benefits; but I don't think that would realistically happen. I think the inflexibility of most state and local government budgets just would not allow that.

The next question is why the federal government is concerned about regulating public plans. I've heard two theories on this. The first theory has to do with the federal budget deficit. Every year the Treasury puts together this list of its highest tax expenditures, starting from the greatest in magnitude on down. Sitting right at the top of the list at over $50 billion are the tax advantages for tax advantaged pension plans. Well, some people think there's an intent to get the hand in the cookie jar. We're talking about substantial sums of money in these public plans, and through tighter regulation and tougher enforcement, maybe the federal government feels that it's going to get its hands on some of that money one way or another, or at least reduce those revenue expenditures in some way.

The other theory has to do with whether or not all that's happening here is the federal government is trying to get public plans under its mantel of authority. The federal government feels pretty clearly, I think at this point, that IR-1869 was bad policy. I think it is the mindset of both the IRS and the Treasury that it really is their mission to bring these plans under their authority, because that is what is laid out in the statutes. Now, the real truth of that is probably somewhere in between. I think that there may be an element here of legislative overreaction very possibly. It could be that the legislature, Congress, is looking at the judges' and legislators' plans and seeing the same type of abuses there as they saw in the doctors' and lawyers' plans and may be overreacting in viewing all public plans in that regard. I think there may be some aspect of that here, too.

With regard to practical issues, the real practical issue is the lack of guidance. If you really want to make an attempt at compliance, it's extremely difficult to do that. As I

mentioned, these rules that we're dealing with were designed for private employers and the IRS really doesn't know a whole lot about public plans. The IRS admits it. As a matter of fact, in a session at this meeting on the message from the IRS, or the dialogue from the IRS, it was stated that the reason why the IRS had the 1993 effective date on the 401(a)(4) regulations for public plans is the IRS thought it would be doing something else by then and wouldn't have to worry about those regulations. I think that was a little tongue-in-cheek, but I think there's maybe an element of truth there.

There are many basic issues that really need to be resolved. Number one, who is the employer in a state and local government situation? Is it the state? Is it the local governments? Is it the special districts involved? Are local governments affiliated in some way in a particular state? Do the control group rules work in some fashion? How do they work? Those kinds of questions really have not been addressed. When you get to the issues of large and multiple employer plans, there is some question as to what is the plan document. Is it what's laid out in the statutes for a particular contracting agency? Is it the specific contract they have? What is the plan amendment? These issues are not very clear. Having discussed them with the IRS myself, it's very clear that the IRS really hasn't thought about the issues and doesn't seem to be planning to think about them maybe for some time to come.

One thing that is clear, though, is that it appears that both the IRS and the Treasury are willing to be educated on this. The other part of the comment made at the IRS session is that the 1993 effective date on 401(a)(4) provides an opportunity for public plans and us, as their consultants, to raise issues with the IRS so it will know what it needs to build into these regulations and how public plans really are different from private plans.

I've had two formal meetings with the IRS where we got into formal guidance in connection with the project that I worked on with the California Public Employee Retirement System and IRC 415. I have been very much struck by the openness and helpfulness of the IRS. I really do believe that it is trying to do the best job in this regard, but the IRS is just not sure what that is. It just doesn't know what to do. One other thing that we'll talk about with respect to nondiscrimination is that the IRS is actively soliciting information upon which it can structure these regulations.

Well, the real practical issue, I think, is, will public plans really change in the light of all of this? As you all are probably well aware, the public plan decision-making process is extremely complicated and extremely slow. There are so many special interest groups involved, with the interested parties getting the legislators involved and actually getting some change enacted takes a substantial period of time. I think in this particular arena these individuals are all used to doing business in a particular way and to try to educate them as to what the implications are of these qualification requirements, the fact that they have to now incorporate this into their already complex decision-making process and institute change, is really a challenge. The typical reaction that I've run into is one of frustration and general outrage of the federal impingement upon the process that everybody is fairly comfortable with at this point and really doesn't need to be made any more complex. I think that this is going to be a major impediment for some years to come in the compliance.

Now, I will get more specific on nondiscrimination. Nondiscrimination, of course, lies at the heart of the system of qualified plans. I think it came in the 1942 Revenue Act. The first nondiscrimination requirements were instituted as part of the qualified plan statutes and regulations. The IRS says that public plan compliance with nondiscrimination is inevitable. It has mentioned that on many occasions. Again, the problem is that the rules are geared toward private employers and don't really carry over to public plans very easily. Let's talk about the type of problems that I'm referring to here.

First of all, with respect to the coverage rules, IRC 410 doesn't apply to government plans. Instead, pre-ERISA 401(a)(3) applies, and if you comply with 401(a)(3), then you're considered complying with 410 for purposes of qualification requirements. Well, 401(a)(3) is a pre-ERISA rule. Again, it begs the question of what constitutes the employer, whether the control group rules apply, or separate lines of business. How about that? How does that fit in here? In those rules there is no exclusion for collectively bargained employees. The nondiscriminatory classification rules include supervisors as part of the prohibited group and both of those last two items are incongruous with the 401(a)(4) regulations. Trying to piece these things together is extremely complicated, and it really is impossible at this point.

Participation rules, which are effective in 1993, are now, of course, less onerous than they were at one time, now that the separate benefit structures have been worked out. Time will tell what problems will arise. We know that possibly with the rules with respect to former employees, some of those safe harbors may be difficult to apply, and only time will tell whether this is going to be a major problem. In regard to Social Security integration, some of the plans use full primary insurance amount (PIA) offsets, and to try to bring these plans in line with 401(l) or to fit under the general 401(a)(4) nondiscrimination rules would be extremely costly. We know that if you have an offset of more than 50%, chances are you're not going to meet the general nondiscrimination rules. What do you do about that? That's not only an issue with respect to qualification, but also it is a very significant budget issue as well.

Specifically with respect to 401(a)(4), the real concern has to do with the inability to meet the design base safe harbors. For example, a plan with one-year final compensation will not fit with the uniform unit credit safe harbor, which is the one that probably most of the plans would be able to fit into if they could. Many plans, at least the ones that I deal with, have multitier arrangements, and these multitier arrangements have been put in for very valid business reasons. For example, in California Proposition 13 limited the property tax revenues. The pension plan benefits needed to be reduced. They can only be reduced for future employees, so you end up with a new classification of employees coming in with a different level of pension benefits. This makes it very difficult to try to impose the nondiscrimination rules, at least with respect to the way that they're currently structured.

This is, of course, all complicated by the anticutback situation which really hasn't been addressed at all. Now, the Treasury has shown some flexibility here. There has been a consortium of national public plan representatives and interest groups and Pat has been involved with this. That includes the Government Finance Officers Association, National Employee Services and Recreation Association, National Council of Public Employee Retirement Systems, and maybe one or two others. What is

happening here is there an attempt at trying to educate the Treasury as to what the real problems are in trying to apply 401(a)(4). There is some indication that there may be special grandfather rules that may be instituted. Now, those could be grandfather rules that attach to a member or even would be to greater advantage if they could attach to prior existing formulas when the rules go into effect. If they were able to apply to an existing formula, then you may be able to get around the problem of Social Security integration at the same time.

It's pretty clear that the Treasury does not want to add a new safe harbor or substantially change any of the safe harbors. It doesn't want to change the safe harbors at all, so the problem that arises there is, once you start fooling around with those things, then the private corporations that sponsor the plans want to get their changes instituted as well. So the Treasury has shown inflexibility in fooling around with those safe harbors as of this point.

Right now there is, at the request of the Treasury, a survey being carried out. I think it was originally intended to incorporate information from 50 of the largest public pension plans in the country, and as a result of time constraints, it's been whittled down to 20. This particular survey is intended to raise issues, to ask plan administrators, representatives, and consultants of public employer funds to tell the Treasury what are the problems you're going to run into when these things are instituted. If there is anyone interested in getting a copy of the survey, I can get it for you. We would certainly love to get some additional input and raise as many issues as we possibly can, because that's really the only way that we're going to be sure that we get workable rules.

Now we'll move over to Section 415. I'd like to give you a very brief update on what the 415 limits are, because these are things that a lot of people don't carry around with them in their brains except to the extent that they've done a lot of work with them. In the 1986 Tax Reform Act we had the special rules for public plans, which really were the pretax reform rules that applied to corporations. Those are full dollar limit down to age 62. Between age 55 and 62 you have an actuarial reduction, but you don't go below this $75,000 floor. For retirement below age 55, you have an actuarial reduction in the $75,000 floor, and you have a special minimum dollar limitation that applies for so-called qualified police and fire employees. Those are police and fire employees who have at least 15 years of service as such.

We have also the grandfather rules and that, as I mentioned, is the ability to protect plan benefits in place as of October 14, 1987. This was the way to get around the state anticutback rules. You adopt the grandfather election and it will protect the benefits in place as of October 14, 1987 for participants who first joined a public retirement system prior to January 1, 1990. When you amend the plan, the grandfather protections do not incorporate any benefit increases that result from those post-October 14, 1987 amendments. In order to institute that grandfather protection, it must be elected by the end of the plan year beginning after December 31, 1989. For many public plans that are on fiscal years beginning July 1, that means that the grandfather rule would have to be adopted by the end of June in order to provide that protection.

The last thing is, if you do elect the grandfather, you do have to impose the private dollar limits on the post-January 1, 1990 plan participants, those who entered the plan after January 1, 1990. The only exception is for the qualified police and fire employees. There's really no impact on them because you still get not only the minimum dollar limit, but also that $75,000 floor; so the public plan limits are still in place for the qualified police and fire employees.

One of the questions, of course, is, what is the impact of 415 on public plans? This was the whole purpose of the study that we carried out for the California Public Employee Retirement System in 1990. Let me describe a little bit about the California Public Employee Retirement System. It is an agent, multiple-employer plan. It includes state employees. It includes a school pool. These are all of the local superintendents of schools. They are part of one benefit arrangement, and they're all funded essentially as a pool. There are, I think, 1,300 or so contracting agencies. They all have the ability to choose from 50-plus contract options, so they can design their own plans, to a great degree, so it's an extremely complicated system.

We went back and took a look at the people who had retired from the Public Employee Retirement System between July 1, 1987 and June 30, 1989, some 25,000 retirees, and we determined what would have been the impact had the 415 limits been in place for these retirees, how many would have been affected, and to what degree. I'm going to give you some information from our executive summary just to give you a flavor for this.

There was 0.79% that had excess benefits averaging about $287 per month at the time of retirement, so we have a very, very small proportion. The majority of those retirees affected by the 415 limits were affected by the percentage limits, not the dollar limits. Actually, about 0.71% out of that 0.79% would have been limited by the percentage of pay limits. Now, we also decided – because of the fact that it was very clear that the percentage limits were going to be important, and the percentage limits are 100% of the high three-year compensation limitation – that there were going to be some important elements with respect to what people do prior to retirement. For example, if they utilize pretax deferral of compensation, 457 plans, 403(b) plans, particularly the catch-up provisions, you can end up reducing the pay upon which the limit is based, and in more cases than not, you have a benefit that's not based on that reduced compensation and it includes those deferrals. You can end up making the situation much worse if you have those kind of pretax savings arrangements and heavy utilizers immediately prior to retirement.

If you have a 414(h)(2) pick-up arrangement, you get dinged in two ways. First, that's not included in the pay that is used to determine the percentage of pay limit, and second, the employer-provided benefit incorporates any contributions made by the member on a pretax basis. That fact is something that we reaffirmed with the IRS on a couple of occasions. With that being the case, we knew that, while we may only see a 0.8% impact now, this was in a situation where 414(h)(2) pick-ups were instituted probably about five or six years ago, in most cases. As time goes on, more and more of the benefits that have been paid for by member contributions will be made under these pick-up arrangements.

We did a 30-year projection under different assumptions. First of all, we assumed that wages went up with a general level of inflation, and second, we used what was termed as a pessimistic scenario because it negatively impacted our results. We assumed that there would be a 1% real wage increase over that 30 years just to see what the impact would be. Now, we went through this projection and determined that, under the assumption that wages increased with the general rate of inflation, ultimately there would be twice as many members affected by the private dollar limits as opposed to the public dollar limits. However, in either case, the percentage of members affected would be very small.

The reason why we looked at that particular element was, if we elect the grandfather provision, then we're going to have the private dollar limits imposed. Under the pessimistic scenario – that's the one that assumes 1% increase in real wages over the next 30 years – there could be a substantially higher proportion of members who are affected by the private dollar limits, and that was a little over 2%. However, we did point out that if you had a 1% real wage increase over 30 years, you'd be talking about pensions that were over 35% higher in purchasing power than they are right now, so that's also an important element.

The other conclusions I've already mentioned are the 414(h)(2) pick-ups and also the fact that deferred compensation is an extremely important element. We also put together a profile of those individuals who were most likely to exceed the limits. The general profile of that individual who failed the percentage of pay test was somebody who retired between age 60 and 64, earning about $40,000-50,000 per year at retirement – and that's in salary, that's not reducing it by the deferred compensation amounts – at 35-plus years of service, was a heavy utilizer of pretax-deferred compensation arrangements in the years immediately preceding the retirement, and was covered under 414(h)(2) pick-ups.

One of the things that I thought was very enlightening in looking at all this is that if these other tax benefits didn't exist – the deferred compensation arrangements and the 414(h)(2) pick-ups – 415 would be pretty much a nonissue with respect to those percentage of pay limits. In the back of my mind I was thinking, Well, maybe the IRS or Treasury or somebody knew about this, and this may be a way to curtail the use of these tax advantages. I don't know if the IRS or Treasury thought that far ahead, but it was certainly an interesting coincidence. The profile of the member failing the dollar limit is age 55, earning over $100,000 at retirement, with 30 or more years of service and also under the 414(h)(2) pick-ups; there are not too many of them. Again, the 414(h)(2) pick-up is important there because it increases the employer provided benefit against which the 415 limit has to be applied.

What we're doing in 1991 is some follow-up work with the Public Employee Retirement System on actually implementing the 415 testing. We are designing and installing software so it can test its retirees as they come out. The Public Employee Retirement System did elect the grandfather election, so its existing retirees and existing members as of January 1, 1990 are protected, at least with regard to benefits in place as of October 14, 1987. There was a substantial increase in benefits that is planned to take place on July 1, 1991. That increase has already been legislated. What happens is state employees would go from a three-year to a one-year final compensation; so now we face the post-October 14, 1987 amendment

problem, and not only did we run into that, but also now we run into IRS Notice 89-45. We now have a 10-year phase-in of the dollar limit. That doesn't look like it's going to be a substantial problem, because we figured that generally you're going to have to have somebody with a benefit increase of over $400 a month and who's retiring at age 55 in order to be impacted. In many cases, this benefit increase wasn't worth quite that much, at least for the most part. So it's another wrinkle that we had to be concerned about.

The last topic that I want to touch upon here is, in order to institute this implementation of testing with the Public Employee Retirement System, we had to do some clarification with the IRS on what its position was going to be because we were, in many cases, operating without the statutory or regulatory guidance. So we planned a meeting with the IRS. We sat down with its representatives, and we took a different approach than we did in our original study. We went through the same exercise in our original study, but the first time we went in and we asked a bunch of questions. What we ended up with is a bunch of questions. What we decided to do this time around was not to go in with a bunch of questions, but to go in with a bunch of answers and to have the IRS tell us that the answers were wrong. I would strongly encourage anyone who deals with the IRS to take that approach because it was very successful. Whether we caught them on a good day or not, I really don't know, but we walked out of there with about 95% of what we hoped to walk out of there with. I do encourage you also to follow up in writing, because the IRS is not going to follow up with you in writing; so we did that.

First of all, we discussed the application of 415 to disability. That was a real big issue when we first got into this – duty disabilities for highway patrolmen as an example. There are benefits that are available, 50-80% of pay that highway patrolmen can get once they become disabled on the job, and this highway patrolman could be there for a very short period of time and, if you had to test this against the 415 limit, it would just blow it away. Well, it turned out that the IRS is really not concerned about disability benefits, except to the extent that they become retirement benefits at some time.

What we were able to do was to segregate out the prenormal retirement age period from the postnormal retirement age period. The prenormal retirement age disability benefit is not subject to the limits, so you go along through the prenormal retirement age period. When you hit normal retirement, then you have to go ahead and test against the limits. Now, at that point you can incorporate, in some cases, service while disabled as service for the employer in determining the limits, and you can also include the increases in the dollar limits, the consumer price index (CPI) increases to the pay as well. At least what this does is it gives us some time before we have to actually worry about imposing those 415 limits to disabilities.

We also found out that the grandfather benefit does attach to an individual. Even if you have someone who moves from one plan to another, his or her grandfather benefit is whatever benefit he or she was entitled to as of October 14, 1987. The other issues that we talked about were reciprocity and one with respect to what I termed delayed gain funding, which actually was one we were very glad to walk out with. In a nutshell, what that means is, when you fund for benefits, you don't have to take the 415 limits into account in funding for your benefits. What the IRS agreed

with us to do is that, when the individual retires, you can essentially take the actual gain that takes place and reflect it at that time. Now, this can allow you to fund other benefits, and here's how you can use this.

You can, for example, set up a plan that provides for additional health benefits in case there's a cutback on the 415 limits. When the person hits retirement and there is actually a cutback, you have the reflection of the gain in the employer contribution rate and that credit on the employer contribution rate can be used to reduce the employer contribution and thus divert funds for other benefits. You can't obviously pull money out of the trust fund, but at least what it allows you to do is create a way to fund those benefits without having to worry about nonqualified trust and that sort of thing; so there are still some ways to be creative.

The last thing I wanted to mention is that there is legislation that is pending in Congress – I think it's HR-1348, the Mansui Bill – which would provide the substantial amount of relief on 415 for public plans. It would eliminate the compensation limit. It would redefine compensation for 415 purposes, provide for excess plans outside of 457, eliminate disability and death benefits from Section 415, and allow for the revocation of the grandfather election within three years after that legislation passes. With that, I will turn it over to Pat.

MS. PATRICIA F. WIEGERT: I'm here to talk about two topics: One topic has to do with pressures on assumptions and I'm going to be discussing that from a plan administrator's perspective, not from a consulting actuary's perspective. The other topic I'm going to talk about is something that is a little bit more near and dear to my heart and that is the concept of phased retirement, and that's under the general heading of benefit trends.

Let me take the first topic and that is the discussion of pressures on assumptions that retirement boards in the public sector are often want to feel. I will be speaking to some of you who have already experienced or at least witnessed some of the pressures being brought to bear on your particular boards or bodies. For the remainder of the people in the audience, I hope that I can provide some insight into what it is that a board feels. I'm going to talk about my particular board. The one I'm dealing with right now is the Contra Costa County Retirement Board.

I've been working with this particular retirement board for two years, and prior to that I was with two other retirement systems and I've seen a number of boards come and go in my 20-plus-year career. I'm going to give you a little background on just exactly what our retirement system is all about and how our board is constituted, because I think that will give you a better feel for the nature of the pressures that my board feels. Then I'm going to talk about the kinds of discretion my board has, and usually where you have discretion, you're going to feel pressures.

My county retirement system is one of 20 retirement systems in the state of California. The authority for them was granted under state law in 1937. My retirement system was actually begun in 1945, but 20 counties in California have chosen to create retirement systems that are more or less grass-root systems established at the county level, and they're pretty much autonomous from the state

legislature, except for the fact that the schedule of benefits is granted or is created in enabling law.

Typical of a public pension system, my system is a defined benefit plan, and also typical of a pension system in the public sector, it's a contributory plan, so the members do contribute to the retirement system. There are about 7,000 active employees, and about 4,000 additional people who are receiving benefits under our system. The employees are pretty much permanent people who are at least half time or more before they gain qualification and membership under the system. They not only work for the county, but also they work for special districts within the county. The special districts, in my case, are cities, cemetery districts, water districts, and fire districts within the county of Contra Costa.

My employers, therefore, are actually a mixed bag also. The county is my biggest participating employer, but we also have the employers that constitute these special districts that are participating in the plan. I think the last count was we had something like 15 special districts in addition to the county, so it's a mixed group of employers and a very mixed group of employees that run anywhere from police and fire people right down to the clerical. We have managers and even elected officials who are covered by our plan. We have about $850 million in assets right now. I haven't looked at the latest market figure; but it's somewhere in excess of $800 million and something less than $1 billion at this point.

Our retirement board is pretty typical. We are a nine-member board. All the members have three-year terms. Half of the board, four of them, are elected by the employees who are covered by the system, and also one of those four people represents the retiree group. The other half, an additional four people, are appointed by the political body in our county, which is called the County Board of Supervisors, and there are some criteria that they have to meet to be eligible for appointment to my retirement board; but they represent the taxpayer or the County Board of Supervisors, the political power within the county. The ninth member is an ex officio position and that's the treasurer of the county. He sits by virtue of the fact that he is the treasurer.

What's unique about our particular system, or at least unique from the systems that I've been exposed to, is what my board has the discretion to do and how the law requires reserves to be established and where my board has discretion above the law or beyond the law to set different reserving requirements. What the board has done with this discretion is rather unique, and this constitutes where the board receives the pressure that it runs into. We have an employee reserve that's obviously set aside. We have something else called a contingency reserve and that probably is not at all unusual. The statute requires that the contingency reserve be established at least 1% of the asset value of the entire trust, but the board could establish a higher percentage. It has to be at least 1%, and it's established for the purposes of offsetting deficiencies in investments in future years.

My board credits whatever it assumes to the employee and employer reserves. If we assume 8.25%, and we have for a number of years, if we don't make 8.25%, we've got a bill to pay, and we've got no money to pay it with, because we credit 8.25% to the member accounts. The contingency reserve is used for that. We dip into the

contingency reserve and presumably we could draw it down to $0, but it's used to cover those cases where our investment income does not meet our assumed rate. What happens when our investment income exceeds the assumed rate? That creates what we call a surplus. The word excess has been used. The word surplus has been used. All those words kind of give me the shudders from the standpoint of a pension plan administrator, but they do use the word, and I will use the word surplus in my presentation here.

When the board receives investment income in any given year that exceeds the 8.25% assumed rate, the board credits 8.25% to the employee accounts. It's got a surplus left over. What to do with it? Well, the board has the discretion to put that money into the employer reserves and offset future increases to reduce contribution rates over the long term. My board also has the discretion to spend that surplus and that's exactly what my board does. For the last ten years, my board has spent the surplus, which runs in excess of what our assumed rate is. We use those dollars to subsidize employee rates. Our employee and employer contribution rates are actually subsidized by surplus dollars in one year that are earned and paid out and they're gone at the end of the year, so it's spent.

For the last 11 years, I think it's been, our board has actually also subsidized retiree costs. There is a provision in law which allows the board to grant a supplemental retirement cost of living. Now, we do have a cost of living provision in our law and it's capped at 3% or 4% depending upon the tier that the people retire in; but there is an automatic cost of living benefit that's granted and it's an escalating thing. Once it's granted it stays, unless the cost of living would drop. There is a provision in the California law that allows county boards to actually grant a supplemental cost of living benefit for one year out of the surplus monies that the board may make in the past year from investments.

Well, you're all actuaries. You know what happens when you make it in one year and you spend it in one year. What happens when you have a bad year? That's where the dilemma is. The pressures on my board just begin with setting the assumption rates. My board does establish economic assumptions and it re-evaluates and makes a fresh decision every year before the valuation process is begun. Drew is my actuary and he can speak to that, because he's brought in once a year to make a recommendation to the board as to what the interest rate and salary rate assumptions should be for the next year. The board also has the discretion to change the non-economic assumptions. We do an experience study every three years, and as a result of that, of course, there are always minor modifications to make to the noneconomic assumptions. The board has the discretion to do that.

The pressure begins with the setting of the economic assumptions every year and it continues and it heats up when the board is faced with a decision of what to do with the surplus that it may have. Believe me, the pressure gets even worse when there is no surplus. We have been, for a good long period, actually reducing or subsidizing employee and employer contribution rates every year. After a while, the recipients of that subsidy are the county, and the special districts, and all the employees out there kind of forget that instead of paying 4% of salary into the retirement system -- and this is an example – they're only paying 2% into the retirement system. They forget that half of that is there. The bill is still being paid, but it's being paid out of surplus

earnings from the last year that the board earned. In my short experience with the retirement board in the last two years, we had one situation where we actually had to cut back on the level of subsidy in one given year because our investment income was not sufficient to pay for the entire subsidy that the board wanted to pay for. That did not sit well with either the county or the employees.

Now, we've got pressure coming from various groups and I think Tom is going to address the wider perspective of where all that pressure comes from. There is pressure coming from the employees who have to shell out hard-earned dollars into the retirement system, which at the ripe age of 25 or 30, they really don't think they're ever going to retire. There is also pressure coming from the employer that is really strapped in California with a budget crisis and would love to see a forgiveness of part of the contributions that it has to pay month after month into the retirement system. The board is really faced with a dilemma every year just because of the surplus earnings business that it has to deal with.

On the one hand, the board can take its surplus and put it into the long-term reserves and lower contribution rates for everybody for the rest of the amortization period for sure; but if the board does that it loses the one-year big bang, the one-year kick that it would have available to it to subsidize contribution rates. It's kind of you either pay me now or pay me later. With the funding crises that various California counties have encountered -- and I think that you're seeing this across the country -- the pressure is to get that one-year bang, the one-year kick, because the dollars going into a reserve to lower contribution rates over the long haul is very small. You see a very small decrease in contribution rates as a result of a $10 million infusion of funds rather than $10 million up-front this year and I can spend it.

There's also pressure as to how these surplus earnings are going to be spent -- not only in setting a higher or lower assumption rate and thereby lower contribution rates or incur greater funding risk -- but also in how those dollars are spent every year by the board. Then there's the pressure of the contingency reserve. I mentioned that the law says the board has to have at least 1% of assets in the contingency. My board has established a 3% contingency minimum. My board is being a little bit more conservative and cautious about long-term funding needs and investment income, and it has established that reserve at 3%. But then there's the pressure of, Well, if we haven't got enough money this year on investment income and we'd like to subsidize contribution rates to the same tune we had last year, then where can we go? We can go into the contingency reserve and draw down from the 3% that the board established to the 1% required by law. There has been pressure to do that.

What we haven't felt the pressure on yet is a change in our amortization period. The board has some discretion to change amortization periods, lengthen them out. We have not had the pressure yet to delay making payments by using vacations, or some kind of a step-rate increase, or delays in effective dates of contribution rates. We have not had the pressure on the distribution of interest that the board has a discretion to make. We credit 8.25% to our member accounts. There is some question as to whether or not the board has to credit 8.25%. Why not 6%? Why not 10%? Why not what you earn? If it's 22%, credit that. There's been no pressure placed on the board in that area yet, and I know that Tom could probably speak to some of those pressures.

I know in my previous life I was experiencing pressure in other retirement systems for that kind of distribution. We haven't had the pressure yet. I suspect that, with increased sophistication among the taxpayers and the members and increased or prolonged deficits on the part of the sponsoring employers, and a poor economy for my members who have to shell out dollars out of their paycheck to pay into the retirement system, the board may see increased pressures in that area.

What do we do about it? I'm a retirement administrator. It's my profession. I feel very strongly that part of my job is to protect my board. I don't like to see its members agonizing over these pressures every year, and I found myself thinking many times in my 20-plus year career, I wish there was something I could do to relieve the pressure from my board members. Wouldn't it be nice if all this discretion that was given to the board by law be eliminated by law changes so that it was a nice, neat little formula and everything was just set in statute? The contribution rates are set and the amortization period is set and there are very little variables. I don't think it would work. I think that, as long as you have pressures and you can relieve the pressures on the part of your individual boards, they're going to bubble up somewhere else. It's kind of like a balloon. You press on one end and you know you're going to increase the pressure somewhere else. I don't think you can totally eliminate pressures and I don't think you really want to.

From a plan administrator's standpoint, I've come to the conclusion that it's part of the healthy checks and balances of the economy, of the retirement systems and the way they're established. I don't think you really want to try to eliminate all pressures. I think that there needs to be a lot of awareness, a lot of education. I would hate for the discretion to be removed from my board and placed at a different level, because the next level up would be the legislature, and I think that the legislature probably is more prone to political pressures than my board is. My board is probably more insulated, as well it should be, from those kinds of pressures. I would prefer to have those questions, the discretion that the board has, remain at the board level because I work with those board members, and I can tell you that they are a highly educated group of people and probably in a better position to understand the needs of the retirement system than somebody further on down the road in another part of the state.

I'll conclude this part of my presentation by just stating that I think the pressure cannot be removed. I don't think it should be removed, but I think it should be better controlled. That comes through education and awareness on the part of the board members, on the part of the taxpayers, on the part of the employees and their representative unions. So when games begin to be played with numbers, with the assumptions, with the amortization periods, with the way you creatively establish your reserves and transfer funds from one pocket to another, when those things start taking place, there is somebody out there who says, "Hey, wait a second! You do something here and you're going to mess it up somewhere else. You're going to affect your funding risk."

I expect that Tom will probably address the dangers that are being faced by other retirement systems across the country. What I did want to give you was a perspective from one retirement administrator's standpoint, not an actuary's viewpoint, as to what her particular retirement board is facing on an annual basis. I'm going to switch

gears now, and talk about something that's near and dear to my heart, and that is benefit trends and something that I would like to see. I would like to challenge the actuarial community, and I would like to challenge the personnel officers who aren't here, and challenge the employers who aren't here, and challenge my fellow administrators who also aren't here; so I'm talking to a very narrow group of actuaries. Since I've got you as a captive audience, you're going to hear it.

You're all actuaries and you're very much aware of what the demographics say. Part of you are probably part of the problem -- baby boomers. I'm on the leading edge of the baby boom group, and so I have a vested desire to see something changed so that by the time I hit retirement age there will be some flexibility given to me as a public employee retiree in my choices in retirement. The Census Bureau says that right now we've got over 12% of people who are over age 65 out there in the population of the United States, and it is predicted that in the year 2030, which is not that too far off, there will be over 21%, almost 22% of the people in the population who will be age 65 or older.

What does that say? That says that if all those people are retired, they're not in the work force, they're not earning income, they're not paying taxes, and they're not paying into Social Security. It also means that there's going to be fewer people in the work force who are coming out of the schools and entering the work force to support us old folk 40 years from now. You also are aware, as actuaries, that there is a changing lifestyle out there. Many of you have newly entered your careers in the last 10 or 15 years; whereas years ago when my father was a young man -- and I'm not going to date myself -- you were expected to stick with a career. You were expected to be hired by your employer and stay right there.

Nowadays, people are no longer expected to stay with a particular job, with a particular employer for a long period of time. You're expected to change careers. You're expected to change employers, and so you become much more portable in your work life. You're also living longer. You're living healthier lives. Age 65 right now may be a desirable age to hang it all up and sit on somebody's rocking chair. But 10 or 15 years from now I think you can expect to see that there will be an increased need for these people in the work force, an increased desire on the part of employees who are facing retirement to stay in the work force, and our pension plans, as we know them now, are not designed to deal with that.

They're designed to deal with, you put in your time, you work your career, you say good-bye to everybody, you hang it up, and you walk out the door. You're either working or you're retired. I've got a feeling that unless the pension community does something with the structure of its pension plans, we will not be meeting the needs of society 10, 15, 20 years out. My challenge, very briefly, to the actuarial community, is to use your creative genius, your access to actuarial science and work with plan administrators and plan sponsors in devising mechanisms that will allow employees who are facing retirement to phase into retirement, to gradually quiesce or gradually slow down their careers, to allow for the changing lifestyles, picking up a different career or hobby, spending some time with the family and traveling, slowing down because of medical needs; but also allowing retirees to keep their fingers in the pie, their foot in the door, allowing mentoring and crosstraining to take place with the people who will be taking over when the retiree finally does retire.

There needs to be a phased retirement situation where I can earn a partial income and receive a partial benefit until such time as I'm ready to, as a retiree, hang it up and go sit in somebody's rocking chair.

MR. THOMAS P. BLEAKNEY: I have to pass along one aspect of the 415 limit. Legislators in Texas get a retirement benefit structure which ties their benefit to the salary of an assistant judge or something of that sort, whose salary is roughly ten times that of the legislator. The benefit formula for legislators is a 2% formula. Two percent times roughly five years, times ten times, means that in about five years they're up at the 415 limit. Just recently the legislature in Texas did an enhancement of its benefits to make them just a little more attractive. The legislators are fully aware of the 415 limit and everything else. They're also counting on the bill perhaps bailing them out; but I also have the feeling that even if the bill does not bail them out, that there will be a tendency in Texas to say forget it. I don't know how many other states are doing that, but I sort of sense this feeling that perhaps the states individually might get rid of the moratorium without doing that which they said they were going to do when they set up the moratorium. I'm not about to do anything about it. I'm not about to take a position on that other than to watch it. I think it's a very interesting and exciting program that's about to be unloaded.

For your own clients, of course, you have to let them know that these are the prospects. What you do about them, of course, is who knows what. Anyway, that's sort of a side issue and I didn't mean to get into that other than the fact that I think it's interesting. That's the exciting part of federal regulations as far as I'm concerned.

I will give just a very brief talk about the GASB situation. Again, I suspect many of you are aware nothing much has really happened in the last several months. The status of the GASB's thinking at the moment on what it is going to do about expensing the counterpart to SFAS 87 is to try to have as much symmetry as possible between the actual contributions in a reasonably well-financed system and the expensing; or, in other words, to avoid wherever possible the minor differences that could occur if the GASB's original exposure draft remained intact.

One of the areas that has been covered is the matter of the amortization period for the unfunded liability. In the original draft the GASB had quite a bit of distinction. If you were already on a cranking down amortization period, you had to continue that. The GASB had no allowance for the very common procedure of having level contribution rates with a floating amortization period, even if that amortization period met the rest of the criteria. So the current concept is to allow great flexibility. Assume this continues to the final exposure draft and ultimately is accepted. The basic concept is to have a 30-year amortization period. It can be either level percentage of pay or level of dollars, with a phase-in currently at a 40-year maximum and in five years phasing into the 30-year maximum.

I have one little thing on that which bothers me, and that is, if a system is taking full advantage of the 40 years, technically, can you really go beyond 35 years if you're the actuary? Because you know in five years, without any actuarial gains and losses, you have to be to the 30-year amortization period. I'm not sure how much that has been addressed. Other than that, I think the general concepts of what's going on

with the GASB are, in my opinion and I suspect many other people's opinion, very favorable to the orderly costing of retirement systems. As long as you're using a satisfactory actuarial cost method, ones that we would all be using, with reasonable assumptions and a reasonable amortization process, it's likely not to create problems.

I'm not going to get any further into that because there are a lot of details that I just really don't have. Nothing much is happening and probably by the time we're here next year I'm not sure that it's going to be settled, although the GASB is hoping to get something out this year. There are a large number of new members on the board and there still are some unsettled issues. The matter of how postretirement increases are to be dealt with is one of them and one that's still leaving my mind at the moment, but there are a couple of issues that still have to be dealt with. By and large, the tenor is that of providing for a satisfactory consonance between the funding of a system and the expensing of a system.

I guess I should mention one other thing. In the exposure draft there was a lot of detail about the choice of economic assumptions, and that is largely going by the board and some attention to what the Actuarial Standards Board will be providing in guidance for the choice of assumptions, but nothing of the specificity that was in the original document. Let me add one other sort of side issue that I had in my outline related to the funding of the systems. It's rather interesting to have this happening at the same time we're finding problems with the actuarial assumptions and with shortfalls on contributions, but I suspect many of you who are dealing with public employee systems are finding the same thing.

As we get to a maturing situation, we have a rather ironic problem of finding that the volatility in the assets causes volatility in whatever our financing bottom line is, either the contribution rate or the amortization period or whatever, and this in itself is creating some problems. I did complete a study a bit ago for a large state which was facing this. One year it had a major system with about a 22-year amortization period. It had some pending legislation that said, "Well, this would hike the amortization period up to 25 or 26 years with this fixed rate, and then the next year the actuary came in with an overfunded system." Well, the legislature didn't like that particular abuse that it took and so it, in fact, ordered this particular study.

In this, we came out with the idea that perhaps their measuring tool of letting the amortization period be the measure when you get to this nearly fully funded situation or, in their case, as they became fully funded -- of course, they settled that by improving benefits -- but nevertheless when they came close to this fully funded situation, the tremendous leverage that's going on causes amortization period in a fixed-rate system to go all over the lot. Among the recommendations that we came in with were such things as changing your target, letting the target now be the contribution rate, and also allowing a little corridor around that target so that, if your next valuation says you're within a quarter of 1% or .5 of 1% of what the last valuation says, don't just jump in and change it. It's sort of like if you're the tiller of a boat. You're not about to change all at once because you moved off a slight bit on where you're trying to go and then you overcorrect and you go back and forth across the lake. You guide it fairly smoothly. I think that's one of the kinds of problems that many of us didn't think we'd ever have to face a few years ago and now it's

increasingly becoming a problem as we get to mature systems. I just wanted to pass that particular commentary on in terms of problems I think many of us share.

In the area of benefit trends, I don't have a great deal that I want to add to what Pat had. New York state had tried out the partial or trial retirement programs. I don't think it was in the teacher system, but in the employee system. The impression I got was that it was not a wonderful, glorious success. In my opinion, and Pat and I can now have an open forum discussion here, the problem isn't so much actuarial. I don't think it's difficult for actuaries to come up with techniques for modifying the benefit, allowing for the benefit structure and the funding for the benefit structure to work out.

I think the problem isn't even in the retirement system level. I really think it's more of a problem at the personnel department, if you will. I think the real problem is finding the kinds of jobs for the people who are retiring or near retiring, where they can move in and out of these jobs without creating chaos. In some instances that may be very easy, but I know in many instances, like the shared job situation, that may or may not work. I'm not saying that we shouldn't all work together to come up with a mechanism for dealing with it, but I don't consider that quite as much an actuarial problem as it is somebody else's problem and therefore I'm not going to talk about it.

Anyway, the other matter that I had on my outline, and I rely heavily upon my outstanding staff people. One of my staff people had covered the question of this New York phase-in benefit and he's off on his honeymoon, which I thought was very inconsiderate of him, but nevertheless I don't have further information on that. The other matter on the outline was having to do with the anti-Betts legislation. It concerns the older workers benefit protection act. The one study that we did for one of our clients on this concerned a disability formula.

This particular state has a projected disability benefit formula such that anybody with less than 30 years of service, upon disablement, gets the benefit that they would then be entitled to if they had 30 years of service; but they also get their accrued benefit if it's greater. That phases in so that the benefit is a very comfortable benefit. If it weren't for the anti-Betts legislation, because there's a major concern in this state about the fact that could be providing a greater benefit to some employees who are younger than for the older employees, because the younger employees are getting this bigger projection in their benefit. That's a nasty interpretation as far as I'm concerned. What do you expect from federal legislation anyway? That's the kind of problem that is faced.

One of the things that we did in that was to study not just the benefit, but also the cost of the benefit. In the course of looking at the costs of the benefits, putting together a matrix by age and service at the amount of benefit as provided, the costs actually taper up fairly nicely because of the increasing cost with the older employee. We found, at least in that particular situation, that the problem was not as severe as we thought. In fact, it was not a problem, at least as we presently view it. That state is taking a very aggressive action to try to get a ruling on its particular formula. It's the state of Idaho, by the way, and it has found that practically nobody in the public sector seems to be worried about this, even though the effective date on this is some time in 1991. I've forgotten when it is, but whenever it is it's right upon us

almost. And in Idaho's instance it thought it had a major problem. I'll be interested if anybody has any comments on a similar situation.

Let me finally spend just a few moments on the question of the pressures on assumptions. A particular kind of pressure, which is very difficult to deal with, I think, is amount of discretion that a retirement board has. This entails how it is going to spend money or even if it has the right to spend the money in the first place. I'm sure most of us are more familiar with the other kinds of pressures that are going on at the present time all across the country. A hot bed of it is in the New England area, where the actuarial assumptions are being manipulated, shall we say to be kind, in trying to keep the contribution rate down; or as in Illinois, where the retirement board doesn't even bother to pay the contributions. Actuaries can have all the numbers in the world, but the people who control the purse string are the people who decide whether they're going to pay the money or not.

I'm going to give just one example that I am familiar with and that is the state of Connecticut. I can't describe the full hierarchy here, but I can give you sort of a general concept where the board of the Connecticut employees system is responsible for carrying out all the actuarial calculations and deciding what the contribution rate should be. Of course, as it always is, the governor and the legislature is the higher authority, but also there is an intermediate responsibility that is shared because of the relationship between the union and management. What has happened in Connecticut has been a memorandum of agreement that took place a couple of years ago at this interim level, at the level of the management and labor, if you will, that set the basis for contributions.

Now, recognize the whole problem wasn't so much the way the retirement system was going, but the way everything else in the state was going, which was, of course, exceedingly tight. In the process, the idea was to save some money in the retirement system so that there would be money available for other employee needs. The memorandum of understanding that took place outside of the board, and which the board bitterly objected to, indicated how the actuarial assumption was to be chosen for the purpose of evaluation. This is the part that just sort of boggles the mind to me.

The way the actuarial assumption in essence was set – and this is a slightly complex averaging process -- was to take what the fund earned the previous fiscal year and going back about three fiscal years and that was the basis for setting this year's actuarial assumption. The long horizon concept is three years. Then it carried forward for two more years with the expectation that this process would lead to the higher interest assumption and therefore lowered contributions. Everybody except the board would be happy and we would lower the contributions. Of course, it worked the first time. The second year, this long-term formula had to deal with the previous year's investment returns, which were nowhere near as good as the previous year's, and lo and behold the thing went down the tube; because the assumed interest rate fell back to what it would have been without the memorandum of understanding.

We don't have to worry about that problem because the next solution was the way the unfunded liability is amortized in the state, and this is one which is a little bit more sensitive at the board level, but the board in Connecticut has routinely amortized the

unfunded liability as a level dollar amortization. There had been indications of what the numbers would have been if there was a level percentage of pay, but when this was brought back to the board, the board said no way. It's got to be level dollar. So the numbers went up again through the same process and what has actually been or is being enacted – as I'm not exactly sure what the time frame was on this – is the contribution is appropriate for a level percentage of pay amortization using what I would consider to be proper actuarial assumptions, but with a shortfall between the level amortization of pay and the level dollar amortization being essentially ignored. It's sort of a nothing, if you will. We're not going to even bring that into consideration. That is my understanding of the situation. I won't guarantee that every little nitpick on that is correct, but basically that's what's going on.

Unfortunately, that's probably one out of 25 examples of the various things that are going on around the country in manipulating the pension funds in order to balance the budget. I'll close with just one general concept. There was an article in *Governing* within the last month or two by John Peterson, who's with the GFOA, in which he suggested that process of borrowing money should be formalized by the issuance of bonds rather than just sort of borrowing the money and forgetting it. I'm not terribly comfortable with that concept. For many years, and it may still continue in Canada, the books were always balanced because any time the retirement board needed money it would just simply issue bonds within the system. It was a pay-as-you-go system with bonds being issued.

Well, that's not really doing the job either, but it does seem to me that perhaps we actuaries should come up with some means to recognize the fact that there is a lot of flexibility in pension funding. We all know that. We need some way of providing a mechanism which was a responsible mechanism, which would allow for the borrowing – and I'm not so sure it needs bonds -- but which would put appropriate discipline upon the states so that when the times were good they would have to put the money back in. When the times were really stressful, as they now are for many states, there would be a means of recognizing this and recognizing it in a responsible fashion. Perhaps that would be a major contribution we could make.

FROM THE FLOOR: The benefits out of the retirement system might have to include the value somehow of health insurance benefits in calculating 415 limits. I haven't had a chance to follow that up anywhere, but do you have any comments on that?

MR. JAMES: In 415, I think there are specific situations, and I'm not sure whether it applies to key employees or highly compensated employees, but if you are funding health benefits through the system and you're using 401(h), I think one of the specific requirements is that the benefits need to be included as part of the 415 limit. I'm not sure whether it's key employees or highly compensated. If it's key employees, then it's academic.

MR. BLEAKNEY: It's key employees.

MR. JAMES: Another question about health insurance. How many of the panelists have clients that are advance funding for health through the pension plan? Is it very common among the audience?

MR. BLEAKNEY: Let me make just one comment. I think the way the advance funding is taking place and the whole concept of retiree medical around the country is a tremendous mishmash. Some have dollar amounts. Some have, like Florida has, just a flat $50 a month that goes in regardless, and that's part of the retirement system benefit structure that's phased in depending on how many years of service you have. Colorado has a program that puts the money aside and it is built up over time to pay on a pay-as-you-go basis for the next 30 or 40 years on a projected basis. But there are so many different programs that it's hard to know and that one is funded, sort of, even though it's pay-as-you-go, but it is actually funded so as to cover these expenditures for many years. Oregon, I've sort of forgotten how it ended up, but it's a peculiar one.

MS. WIEGERT: It's a mess. They're attempting to prefund it.

MR. MICHAEL E. SWIECICKI: I'm with California Public Employee Retirement System. I'm reasonably familiar with everything, but I have a few comments. I think maybe with regard to the 415 limits, a third reason that this might be coming out is a general dissatisfaction among the population that the states and the local governments aren't really paying attention to abuses. There aren't a whole lot of abuses, but when they come up they're well-publicized and there's a lot of upset people.

In California, a popular vote eliminated the legislators' retirement system recently. A lot of people suspect, and I've seen instances of it, where there's really almost apparent collusion among the various groups in government to get as much as they can out of the retirement system, and it's not always in the best interest of the participants in the long run. In California, a real dangerous precedent has been set recently where the system had a budget problem last year, and everybody said, Well, we have to maintain good funding to unions and what not. The unions said these are our benefits. You can't loosen up the funding. Well, the other side came back and said, We'll improve your benefits. The other side gave the unions one-year final compensation and the other side relaxed the funding, so the unions ended up paying much less. That was the compromise. Give us more and you can pay less. That sort of thing I consider pretty dangerous.

I've noticed a little bit of pressure here and there for various assumption changes. California, again, is very close to a compromise that is even weaker than pay-as-you-go. It would be like pay-after-you-die types of benefits. California does have a reasonable four-legged approach to retirement. The partial working after retirement is reasonably common within the state, and California has expanded that quite well. I think that's inevitable, too. Now they're up to four legs at least. I think it's inevitable. On the other side, California is going strange in the other direction because there are a lot of incentives to retire people early. The state is coming up with even stronger programs at the earlier ages which have no other effect except to get people out earlier, which is hard for the state to be consistent, I suppose.

Our funding is always up to pressure. It's an interesting spectacle to watch and be somewhat a part of, as Drew realizes, too.