W F CORROON

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Mr. Bruce Staniforth
Executive Director
Los Angeles County Citizens
Economy and Efficiency Commission
500 W. Temple
163 Hall of Administration
Los Angeles, California 90012

Dear Mr. Staniforth:

Enclosed please find the Comparability Analysis of Los Angeles County Employees' Retirement Benefits.

We are hopeful that this report will prove useful and help the Commission to develop its recommendations for the Board of Supervisors.

Sincerely,

Drew A. James, F.S.A.
Senior Vice President
Senior Consulting Actuary

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Tanya Yip

Tanya M. Yip
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DAJ:lw

Enclosures

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INTRODUCTION

W F Corroon was retained by the Los Angeles County Economy and Efficiency Commission to:

- Provide the Commission with an objective and comprehensive analysis of the policies and practices governing retirement-eligible salary and benefits of LACERA as compared to other analogous public and private pension systems;
- Provide recommendations that enable the development of effective policies and practices in the area of pension system structure and management, focusing on those issues related to retirement-eligible salary and benefits; and
- Provide innovative, alternative approaches to the accomplishment of the above recommendations.

This report provides the results of this assignment.

In order to achieve the objectives, the following methodology was used:

1. A "typical employee group" was created to represent a cross section of County General Member employees.
2. This typical employee group was tested for:
   - The adequacy of employer and employee provided retirement benefits from Los Angeles Retirement system Plans D and E and the Los Angeles County 457 and 401(k) retirement savings plans;
   - The equity of these retirement benefits between the typical employees; and
   - The comparability of these County retirement benefits with those provided by a sample of comparable public and private employers.
3. The County retirement program was evaluated and based on the above criteria, recommendations for possible improvements were made.

We hope that this report will prove informative and useful to the Commission in the formulation of its recommendations to the Board of Supervisors.

EXECUTIVE SUMMARY

SECTION 3.1
METHODOLOGY

The assumptions and methodologies employed in our analysis are disclosed in this section. The pivotal elements include:

- Focus on retirement plans "open" to new hires.
- Evaluation of all retirement income sources available from the employer.
- Use of the County retirement system actuarial assumptions where applicable.
- Identification of a group of six "typical employees", which in total provides a representative cross-section of LA County General employees.
- Exclusion of Safety members from the study due to significant differences in responsibilities and, therefore, benefits between these employees and private sector employees.
- The typical employees are:

REPRESENTED	JOB TITLE
SEIU Local 660	Secretary I
Coalition	Property Agent II
NONREPRESENTED	**JOB TITLE**
Other	Senior Secretary III
Professionals/Managers	Data Processing Manager I
Performance Based Pay Recipients	Data Processing Manager III
Senior Management/ Department Heads	Auditor Controller

Section 3.2 General Analysis: Adequacy Element

This section of the report deals with the following question:

Do the benefits under the County's retirement program provide an adequate level of retirement income to all classes of our typical employee group?

- The results of our measurement indicate that:
  - At retirement, the income for the typical employee group is generally adequate to sustain the employee's preretirement lifestyle when employee contributions are considered. The County-funded portion of benefits replaces 50% to 80% of net preretirement earnings.
  - Inflation of 5% will result in a reduction in average purchasing power over the employee's retirement years of 30% for the typical employees covered under Plan D and 40% under Plan E. These reductions do not include the purchasing power protection promoted under the STAR supplemental cost-of-living program for Plan D.
- Adequacy measures are based upon benefits generated from amounts funded by *both* the County and the employee from:
  - The County Retirement System, plus
  - The County's 401(k) and 457 Retirement Savings Plans, and
  - For the DP Manager III and Auditor Controller positions under Plan E, amounts generated from personal savings, to the extent that these employees were precluded from making full contributions to the 401(k) plan due to federal limits.

Section 3.3 Intra-County Comparision: Equity Element

This section of the report deals with the following question:

Is the County retirement program equitable to all classes of our typical employee group?

Our equity measure is based upon the Retirement Benefit Adequacy Coefficient (RBAC) developed in Section 3.2.

- As measured by the RBAC, the typical employees in the Choices and the Options flexible benefits plans receive less adequate retirement benefits than the typical employees who participate in the MegaFlex plan. This is the direct result of the level of flexible benefit cash options included as pensionable earnings.
- The results of equity tests among the typical employees who participate in the MegaFlex plan indicate a bias towards highly compensated employees (based on the IRS definition of "highly compensated employees"). The desirability of this situation is a compensation and benefit policy issue.

- The Commission may want to recommend further study of executive compensation and benefits issues as they relate to public and private sector employees.

SECTION 3.4 COMPETITIVE ELEMENT

This section of the report deals with the following question:

How competitive are County benefits when compared with other entities, both public and private?

- When viewed in the aggregate, Los Angeles County provides retirement income plans comparable to those available to the 17 other employers surveyed.
- In comparing the forms of compensation includable in pensionable earnings, Los Angeles County is unique among those surveyed for including transportation allowance, security allowance, and county flexible benefit contributions. However, survey data provided to us by the Commission indicated that some of the smaller 1937 Act retirement systems include these items in pensionable earnings.

SECTION 3.5 FUNDING/ ACTUARIAL ISSUES: FINANCING ELEMENT

This section of the report deals with the following question:

Are the Retirement System benefits being funded in a reasonable and a responsible manner considering the increases in liabilities that have occurred as a result of the inclusion of flexible benefit cash options and other additional compensation elements into pensionable compensation?

- Though contribution levels have been increased, the funded status of the system remains sound.
- There was a decrease in the government accounting standard funding ratio from 84.9% as of June 30, 1990 to 81.5% as of June 30, 1991. Even with this reduction, the Los Angeles County system's funded ratio is above that of the median county retirement system, and sits very close to the average for all these systems.
- Actuarial Assumptions

  In general we found the actuarial assumptions used by the Retirement System to be reasonable and consistent with those used by other 1937 Act county retirement systems. There are three specific items we would comment on:

  - Options Flexible Benefit Plan

    An additional increase in unfunded liability will occur when flexible benefit cash options attributable to the Options plan, first effective in 1992, are included in actuarial calculations.

- Population Growth Assumption

  We recommend that the Board of Investments review the appropriateness of the 1% growth assumption when the amortization period is reevaluated in four years.

- Future Flexible Benefits Amounts under Choices

  It was assumed in the actuarial valuation that the cash option available under the Choices plan will increase at the same rate as future salaries, i.e., 6% per year. If it increases more rapidly than this (e.g., if it increases in unison with increases in medical premiums under the Choices plan) there will be substantial future increases in the unfunded liability.

  This is an area where there is need for close coordination between County administration and the Retirement System so that all parties are acutely aware of the retirement cost implications of future negotiated cash options available under the Choices plan. These same concerns will also apply to the cash option under the Options Flexible Benefits Plan.

◆ Fiscal Management Policies

Government Code Section 7507 requires that actuarial studies to determine future annual costs be carried out by "local legislative bodies" before authorizing increases in public retirement plan benefits. This legal requirement should not be the sole guide to responsible fiscal management of retirement benefit costs. The County management must maintain a consistent policy of formally communicating with the Retirement System Boards and staff to be sure that retirement cost implications of their actions are evaluated before they are instituted.

◆ STAR Program

Future costs of continuing this program will increase because of the inclusion of the additional compensation elements in pensionable earnings.

Section 4: Conclusions and Recommendations

Basis Upon Which Recommendations Are Developed

The core conclusions upon which our recommendations have been developed are:

◆ Retirement Benefit Adequacy

In general, the benefits are not overly generous when one considers that a substantial portion of the benefit is funded by the employee, and the reduction in benefit adequacy that occurs through the inflationary losses in purchasing power after retirement.

- **Retirement Benefit Equity Among Employees**

  Using our typical employee group as a basis for comparison, County funded retirement benefits are more adequate for the employees participating in the MegaFlex plan. Within the MegaFlex covered group, County funded retirement benefits are more adequate for the highly compensated employees.

- **Competitiveness of Los Angeles County Retirement Program with Comparable Public and Private Employers' Programs**

  In general, the programs are comparable with the exception of benefits provided to highly compensated employees. This is the direct result of the inclusion of compensation elements such as County contributions toward the flexible benefit plan and transportation allowances into pensionable earnings. These items are not used by any other employers in our sample.

- **Financing Element**

  The additional compensation elements that have been introduced into pensionable earnings have resulted in an increase in the unfunded liability of $265 million. This does not include the effect of the Options flexible benefit plan implemented for Local 660 members earlier this year. There are potentially added future costs that may result from the continuation of the STAR supplemental cost of living program for future retirees. The additional unfunded liability has been determined assuming that the cash options under the Choices program increases at 6% per year in direct proportion with increases in salary. To the extent that this amount increases at a different rate, the unfunded liability can increase.

Before offering possible solutions to the issues raised above, it is important to discuss the realistic potential for implementation of solutions.

RECOMMENDATIONS

The recommendations which follow have important legal, labor relations and policy implications which must be carefully considered before they are implemented. They have not been given any legal review. They have been formulated under the assumption that reductions in retirement plan expenditures are an important fiscal objective. Adoption of these recommendations must be considered in terms of their impact on the entire compensation and benefits package of County employees.

1. Flexible Benefit Cash Options

   In our opinion, granting higher pension benefits when flexible benefit plan cash options are available does not spend employer benefit dollars in the most effective manner. Pension increases so provided are not necessarily essential from a retirement benefit design prospective, but are being brought about as a side-effect of flexible benefit plan design and legal interpretation.

Thus, it may well be the case that county dollars spent to support these pension increases would be better spent in other benefit areas or to make different improvements in the retirement area. For this reason, we suggest that future increases in the cash options under the Choices and Options plans be carefully considered, controlled, or possibly eliminated, unless compelling arguments in other areas argue for their increase. In addition, we suggest that the cash option under the MegaFlex and Flex Plans be reduced by one or both of the courses set out below to the lowest level consistent with acceptable flexible benefits plan design and prior commitments to employees.

a. Freeze the MegaFlex plan cash option at its present dollar level for each employee. Any increase in the County contributions to these plans would be provided in the form of benefits rather than cash options.

b. Offset future cost-of-living pay increases granted to employees in the MegaFlex Plan against the MegaFlex cash option. The rationale for using the offset is to avoid reducing the present take home pay available to employees.

   For example, assume an employee is entitled to a County contribution to MegaFlex equal to 17% of salary, all of which is available to be taken in cash. For illustrative purposes, assume that a 3% cost of living raise is given on July 1, 1992. The January 1, 1993 MegaFlex cash option would be reduced to 14%, the 17% option reduced by the 3% pay increase. There would still be a 17% of salary MegaFlex contribution, but there would be less available to take in cash. This strategy could be used to bring the MegaFlex cash options with the Options and Choices plans closer over time. We understand that only 15% of employees are taking all of their MegaFlex contribution in cash.

   To lessen the impact of the reduction of the cash option on employees, the expansion of MegaFlex and Flex to include 401(k) could be investigated.

2. The County should explore the feasibility of offsetting County retiree health insurance contributions by the retirement benefit increases resulting from the inclusion of the flexible benefit amounts into pensionable earnings.

   In Section 3.2 we addressed the policy issue of what the appropriate pay base should be to measure income replacement for retirement benefit purposes. We believe that the mere existence of a flexible benefits plan does not create the need for additional retirement income. The County contributions to the flexible benefit plans resulted from a conversion of employee benefits into cash equivalents. Once these benefit values are incorporated into the pension formula, the retirement program begins replacing both income *and* benefits. As a result, there may be justification to use the increase in benefits that a retiree gets from incorporating flexible benefits amounts into pensionable earnings against the amounts the County would otherwise contribute to that retiree's medical benefits.

As an example, assume an employee retires at age 62 from Retirement Plan D with 30 years of service. Assume further that the employee has final annual earnings of $30,000 before including the MegaFlex annual cash option and $35,100 after including it. The retiree is entitled to a monthly retirement benefit of $1,835.14 of which $266.65 is due to the inclusion of the MegaFlex cash option. This employee would be required to contribute towards the cost of retiree health insurance up to the lesser of the cost of the chosen coverage or $266.65 per month. In future years, the $266.65 would be increased with cost-of-living adjustments.

In effect this extends the flexible benefits concept into the retirement years (albeit without the tax advantages) since the retiree can choose to contribute towards and participate in the County health plan, or to keep the $266.65 per month.

3. Eliminate the incorporation of flexible benefits amounts and transportation allowances from pensionable earnings for new hires. To lessen the impact of the reduction of the cash option on employees, the expansion of MegaFlex and Flex to include 401(k) could be investigated.

4. Either include all future special salary deferral arrangements in pensionable earnings on an as-earned basis or discontinue such salary deferral arrangements. This practice promotes "spiking" of pension benefits which produces inequitable benefits and understatement of ultimate pension costs.

5. The evaluation of executive compensation and benefits issues as they relate to public and private sector employees is beyond the scope of our study. The Commission may want to recommend that this issue be studied further.

3.1 METHODOLOGY

KEY POINTS

The assumptions and methodologies employed in our analysis are disclosed in this section. The pivotal elements include:

- Focus on retirement plans "open" to new hires.
- Evaluation of all retirement income sources available from the employer.
- Use of the County retirement system actuarial assumptions where applicable.
- Identification of a group of six "typical employees", which in total provides a representative cross-section of LA County General employees.
- Exclusion of Safety members from the study due to significant differences in responsibilities and, therefore, benefits between these employees and private sector employees.
- The typical employees are:

REPRESENTED	JOB TITLE
SEIU Local 660	Secretary I
Coalition	Property Agent II
NONREPRESENTED	**JOB TITLE**
Other	Senior Secretary III
Professionals/Managers	Data Processing Manager I
Performance Based Pay Recipients	Data Processing Manager III
Senior Management/ Department Heads	Auditor Controller

Methodology

Retirement Plans Considered

A forward looking approach was taken. Thus, retirement and flexible benefit plans considered in our study were only those available to new employees. This approach produces the most comparable results by comparing benefit designs at the same point in time. It also focuses on benefits available to new hires from other employers competing in the same workforce markets.

Since the duties of Safety members are substantially different than those of most private sector employees and have a considerable impact on the design of their retirement benefits, we have excluded Safety members from this study.

For most portions of this study, we included all retirement income sources available to employees of Los Angeles County and the other employers studied. This includes not only pension benefits but also retirement savings plans and other retirement plans.

Typical Employees

An important element in this study is the need to evaluate how the various compensation items affect the level of retirement benefits when viewed from a number of different perspectives: the adequacy of the benefits, the equitable treatment of different classes of employees, and the level of benefits relative to other comparable public and private sector organizations. The methodology we used was to select a representative group of "typical employees" from various distinct classifications within the County. Taken together, these typical employees then comprise a representative cross-section of the employee population.

In order to reflect differences in pensionable compensation, the classes were based on their flexible benefits plan coverage and the other *special* forms of compensation typically received. Within each class, a sample General member job title, representative of the General members of the group, was chosen. Hypothetical employees from these job titles were used for comparisons throughout the report. The classes and associated job titles were:

Illustration 3.1.1

Represented	Job Title
SEIU Local 660	Secretary I
Coalition	Property Agent II
Nonrepresented	**Job Title**
Other	Senior Secretary III
Professionals/Managers	Data Processing Manager I
Performance Based Pay Recipients	Data Processing Manager III
Senior Management/ Department Heads	Auditor Controller

Assumptions

Major assumptions used in our study are discussed below. The Appendix at the end of the report contains details on all assumptions utilized in our calculations.

Compensation

Earnings utilized in our study for each of the job titles are shown in Illustration 3.1.2. Pensionable earnings for the Los Angeles County Employees' Retirement System are separately noted. The earnings were reviewed and approved by a representative with the Chief Administrator's Office.

Compensation reported for these job titles represents estimated compensation at retirement. Thus, base pays utilized are the highest step pay for the job title.

In order to reflect special compensation items in this study, hypothetical employees in eligible job classifications are assumed to receive transportation and security allowances and employees in the first three job titles are assumed to receive bilingual pay. In addition, coverage under the appropriate flexible benefit plan is assumed.

It is assumed that any deferred compensation is included in pensionable earnings at the time it is earned, rather than paid, in conformance with the recently adopted Retirement System policy.

In order to determine total compensation, estimates of average overtime pay and average pay for shift differentials for all employees having the same job title have been included. Since no bonuses are currently paid by the County and it is not anticipated at this time that this form of compensation will be payable in the future, it was assumed that no such bonuses would be paid.

Compensation Increases

Increases in compensation were comprised of two parts, inflation and promotion (step) increases. Since comparisons of benefits are being made for new hires, and thus, assumptions must be long term, the assumptions used for the actuarial valuation of the system, 5% and 1% respectively, were used for the first 3 job classifications. For DP Managers I and III and Auditor Controller, the 5% inflation assumption was used along with a 1% per year promotion assumption during the last 5 years of employment and promotion increases during the first 25 years of 1.7% per year for DP Manager I; 2.5% per year for DP Manager III; and 4% per year for Auditor Controller.

Retirement Benefits

Assumptions regarding the typical employee profile are shown in Illustration 3.1.3. Where available, free continuance of retirement benefits to a surviving spouse was taken into account, assuming that 70% of the employees were married at retirement. Automatic cost of living benefits were also taken into account. For private employers, where cost-of-living benefits are typically not automatic, but offered from time to time, such benefits were only included if a pattern was considered to exist by the company's auditors as evidenced by projection of future cost-of living increases in the pension liabilities included in the corporations' annual financial statements.

Interest rates used to determine the value of retirement benefits and the growth of accounts under the retirement savings plans were set at 8% per year. This is the interest rate assumption used in the actuarial valuation of the Retirement System.

Illustration 3.1.3

Typical Employee Profile	
Employee's age at retirement	62
Beneficiary's age at retirement	62
Years of Service at retirement	30
Employee's age at hire/entry	32

Illustration 3.1.2

Typical Employee Monthly Compensation

Types of Compensation	Represented Local 660 Secretary I	Represented Coalition Property Agent II	Nonrepresented Other Sr Secretary III	Nonrepresented Professionals & Managers DP Manager I	Nonrepresented Performance Based Pay DP Manager III	Nonrepresented Dept Heads/ Senior Mgmt Auditor Controller
Monthly Base Salary	$2,230	$3,844	$2,984	$6,183	$7,854	$11,275
Shift Differentials	$4	$0	$0	$0	$0	$0
Bonus	$0	$0	$0	$0	$0	$0
Transportation/ Security Allowance	$0	$0	$0	$0	$510	$525
Flexible Benefits	$244	$244	$524	$1,051	$1,355	$1,917
Other Compensation (e.g. Bilingual Pay)	$80	$80	$80	$0	$0	$0
Pensionable Earnings	$2,558	$4,168	$3,588	$7,234	$9,699	$13,717
Overtime	$22	$38	$15	$6	$0	$0
Gross Earnings (w/o Flex)	$2,336	$3,962	$3,079	$6,189	$8,364	$11,800

3.2 General Analysis – Adequacy Element

Key Points

This section of the report deals with the following question:

Do the benefits under the County's retirement program provide an adequate level of retirement income to all classes of our typical employee group?

- The results of our measurement indicate that:
  - At retirement, the income for the typical employee group is generally adequate to sustain the employee's preretirement lifestyle when employee contributions are considered. The County-funded portion of benefits replaces 50% to 80% of net preretirement earnings.
  - Inflation of 5% will result in a reduction in average purchasing power over the employee's retirement years of 30% for the typical employees covered under Plan D and 40% under Plan E. These reductions do not include the purchasing power protection promoted under the STAR supplemental cost-of-living program for Plan D.
- Adequacy measures are based upon benefits generated from amounts funded by *both* the County and the employee from:
  - The County Retirement System, plus
  - The County's 401(k) and 457 Retirement Savings Plans, and
  - For the DP Manager III and Auditor Controller positions under Plan E, amounts generated from personal savings, to the extent that these employees were precluded from making full contributions to the 401(k) plan due to federal limits.

Measure of Adequacy

A pension plan is designed to replace some portion of an employee's compensation after retirement. Analytical techniques have been used to determine the proportion of compensation necessary to provide a comparable standard of living as employees enter retirement. These proportions are commonly referred to as "replacement ratios".

Note that the adequacy measures are based upon benefits generated from:

- The County Retirement System, plus
- The County's 401(k) and 457 Retirement Savings Plans, plus
- For the DP Manager III and Auditor Controller positions under Plan E, amounts generated from personal savings, to the extent that they were precluded from making full contributions to the 401(k) plan due to federal limits,

and represent amounts funded by *both* the County and the employee.

Determination of Replacement Ratios

We used the following procedure to calculate the replacement ratios for our typical employee group (Note: the lettering refers to the columns in Illustrations 3.2.1 and 3.2.2):

a. **Gross Preretirement Income**

This is the total pay for our typical employees in the year immediately preceding their retirement. It represents the before-tax earnings upon which an employee's disposable income is ultimately based. County contributions to the flexible benefits plans are *not* included.

The reason for excluding flexible benefit contributions in gross preretirement income is that the mere existence of the flexible plan should not affect the level of retirement income needed by the employee. An example might be to compare two identical employers with the exact same benefit and pay structure, except employer #1 provides a flexible benefits plan and employer #2 does not. There is no justification why an employee of employer #1 has any need for a higher pension solely because of the existence of the flexible benefits plan. Therefore, the preretirement income upon which we measure retirement benefit adequacy should be the same for each employer.

Another way to view this would be to compare two identical employees, one employee who retires prior to the implementation of a flexible benefit plan and an employee who retires after the implementation of the flexible benefit plan. The mere existence of the flexible benefit plan creates no *need* for a higher pension benefit for the second employee. Thus the preretirement income upon which to measure adequacy should be the same for each employee. It may be that because the second employee contributes more to the retirement plan (because member contributions are based on compensation including the flexible benefit contribution) he or she is entitled to a more adequate benefit, but the basic adequacy measure should be the same. In implementing the flexible benefits plan, all that has happened is that certain employee benefit elements have been converted to their cash equivalent and offered back to employees as either cash or benefits.

The only situation in which one might have justification for including the flexible benefits contributions would be if the flexible benefits plan was provided in exchange for a reduction in salary or in lieu of salary increases. Any salary reduction amounts are included in the preretirement earnings used for measuring adequacy, and we understand that no salary increases were foregone upon the implementation of the County's various flexible benefits plans.

b/c. **Preretirement Taxes**

The federal and state income tax rates are based upon 1991 rates for a single taxpayer taking the standard deduction with one exemption. Medicare taxes are also included.

d. **Disposable Income**

This is the after-tax preretirement income.

e. **Preretirement Savings**

This is the amount of retirement savings being contributed to the retirement system, the County's Section 457 and 401(k) plans and personal savings for the DP Manager III and Auditor Controller positions in Plan E. The basis for these amounts is provided in the Appendix.

f. **Net Preretirement Income**

This is the disposable income net of retirement savings amounts and represents the preretirement income basis upon which the retirement income is compared.

g. **Gross Initial Annual Retirement Income**

This is the amount that will be provided by the County's retirement program (including benefits from the Retirement System, 401(k), and Section 457 retirement savings plans), plus amounts that will be derived from personal savings for the DP Manager III and Auditor Controller positions in Plan E to the extent they are otherwise precluded from making full 401(k) contributions because of the federal limits. This last item is necessary to reflect the retirement income generated by these employees' savings patterns, which are assumed to be the same regardless of whether they participate in Plan D or E.

h/i. **Postretirement Taxes**

Calculated on the same rate basis as the preretirement taxes.

j. **Net Initial Annual Retirement Income**

The after-tax postretirement income.

k. **Initial Replacement Ratio**

This is the ratio of the net preretirement income provided to the net initial annual retirement income.

REPLACEMENT RATIO ANALYSIS

A replacement ratio analysis for our typical employee group is provided in Illustration 3.2.1.

Note that Illustration 3.2.1 ratios include benefits generated from member and County contributions to both the County Retirement System and the County's retirement savings plans (401(k) and 457 plans).

Some of the replacement ratios in Illustration 3.2.1 might appear somewhat surprising at first.

- **Plan E ratios generally exceed those of Plan D**

  Illustration 3.2.1 was prepared assuming that the Plan E participant deposits the full amount of what would otherwise be the Plan D member contribution into one of the County's retirement savings programs, receiving the appropriate employer match*. Thus, employees are assumed to contribute the same amounts toward their own retirement benefits regardless of whether they are covered under Plan D or Plan E. The savings plans can provide a higher initial retirement benefit for employees who receive annual pay raises of 6% throughout their career. Savings plans generate lower replacement ratios for employees who receive higher pay increases during their career, thus the Plan E ratios are closer to those of Plan D for the Auditor Controller, DP Manager III, and DP Manager I positions.

  Also bear in mind that the Plan E replacement ratios in Illustration 3.2.1 will only materialize if the investment return in the savings plans is 8% annually. The employee's benefit will be lower if this return is not achieved.

  Because Plan D has a cost of living benefit and Plan E does not, we need to extend the analysis

* There are legal maximum dollar limitations on employee contributions to the County's 401(k) plan. As a result, the DP Manager III and Auditor Controller positions covered under Plan E are precluded from depositing the full Plan D contribution amount into the 401(k) plan. It is assumed that the difference goes into a personal investments program on an after tax basis.

ILLUSTRATION 3.2.1

RETIREMENT PLAN D

Typical Employee	Gross Preretirement Income (1) (a)	Preretirement Taxes: Federal (2) (b)	Preretirement Taxes: California State (c)	Disposable Income (d) = (a) - (b) - (c)	Retirement Savings (3) (e)	Preretirement Income (f) = (d) - (e)	Gross Initial Annual Retirement Income (g)	Postretirement Taxes: Federal (h)	Postretirement Taxes: California State (i)	Net Initial Annual Retirement Income (j) = (g) - (h) - (i)	Initial Replacement Ratio (4) (k) = (j)/(f)
Secretary I	$28,041	$3,403	$827	$23,811	$2,713	$21,098	$21,125	$2,336	$551	$18,238	86%
Property Agent II	47,549	8,621	2,401	36,527	4,451	32,076	34,614	5,493	1,597	27,525	86%
Sr Secretary III	36,947	5,626	1,462	29,859	4,228	25,631	34,421	5,438	1,579	27,404	107%
DP Manager I	74,270	15,391	4,425	54,454	9,241	45,213	72,969	16,775	5,164	51,030	113%
DP Manager III	94,248	21,179	6,030	67,039	11,965	55,074	95,812	23,830	7,243	64,739	118%
Auditor Controller	135,300	33,096	9,484	92,720	17,080	75,640	130,448	34,754	10,706	84,987	112%

Notes:
(1) Excludes flexible benefit amounts, transportation allowances and deferred salary received during the year.
(2) Includes medicare taxes.
(3) Includes taxes on savings and investments that are made on an after tax basis.
(4) Net retirement income as a percentage of net preretirement income.
(Assumptions are an integral part of this analysis – refer to Appendix)

RETIREMENT PLAN E

Typical Employee	Gross Preretirement Income (1) (a)	Preretirement Taxes: Federal (2) (b)	Preretirement Taxes: California State (c)	Disposable Income (d) = (a) - (b) - (c)	Retirement Savings (3) (e)	Preretirement Income (f) = (d) - (e)	Gross Initial Annual Retirement Income (g)	Postretirement Taxes: Federal (h)	Postretirement Taxes: California State (i)	Net Initial Annual Retirement Income (j) = (g) - (h) - (i)	Initial Replacement Ratio (4) (k) = (j)/(f)
Secretary I	$28,041	$3,403	$827	$23,811	$2,713	$21,098	$25,363	$2,972	$805	$21,586	102%
Property Agent II	47,549	8,621	2,401	36,527	4,451	32,076	41,556	7,436	2,242	31,878	99%
Sr Secretary III	36,947	5,626	1,462	29,859	4,228	25,631	41,300	7,365	2,218	31,717	124%
DP Manager I	74,270	15,391	4,425	54,454	9,241	45,213	81,144	19,310	5,924	55,911	124%
DP Manager III	94,248	21,179	6,030	67,039	11,965	55,074	103,583	25,321	7,715	70,547	128%
Auditor Controller	135,300	33,096	9,484	92,720	17,080	75,640	132,834	32,870	10,107	89,857	119%

Notes:
(1) Excludes flexible benefit amounts, transportation allowances and deferred salary received during the year.
(2) Includes medicare taxes.
(3) Includes taxes on savings and investments that are made on an after tax basis.
(4) Net retirement income as a percentage of net preretirement income.
(Assumptions are an integral part of this analysis – refer to Appendix)

The Initial Annual Retirement Income includes benefits generated from member and County contributions to the County's retirement system and savings plans (401(k) and 457 plans).

ILLUSTRATION 3.2.2

RETIREMENT PLAN E

Typical Employee	Gross Preretirement Income (1) (a)	Preretirement Taxes: Federal (2) (b)	Preretirement Taxes: California State (c)	Disposable Income (d) = (a) - (b) - (c)	Retirement Savings (3) (e)	Preretirement Income (f) = (d) - (e)	Gross Initial Annual Retirement Income (g)	Postretirement Taxes: Federal (h)	Postretirement Taxes: California State (i)	Net Initial Annual Retirement Income (j) = (g) - (h) - (i)	Initial Replacement Ratio (4) (k) = (j)/(f)
Secretary I	$28,041	$3,929	$987	$23,126	$449	$22,677	$15,512	$1,494	$278	$13,740	61%
Property Agent II	47,549	9,587	2,726	35,236	761	34,475	25,466	2,987	819	21,659	63%
Sr Secretary III	36,947	6,382	1,713	28,852	1,068	27,785	26,585	3,244	909	22,432	81%
DP Manager I	74,270	17,360	5,016	51,894	2,889	49,005	57,221	11,894	3,699	41,629	85%
DP Manager III	94,248	23,528	6,780	63,940	3,904	60,036	74,717	17,184	5,326	52,207	87%
Auditor Controller	135,300	36,512	10,641	88,147	5,508	82,639	100,615	25,346	7,723	67,546	82%

Notes:
(1) Excludes flexible benefit amounts, transportation allowances and deferred salary received during the year.
(2) Includes medicare taxes.
(3) Includes taxes on savings and investments that are made on an after tax basis.
(4) Net retirement income as a percentage of net preretirement income.
(Assumptions are an integral part of this analysis – refer to Appendix.)

The Initial Annual Retirement Income includes benefits generated from member and County contributions to the County's retirement system and savings plans (401(k) and 457 plans).

later into retirement before drawing any conclusions about the relative value of the two plans. There are other differences that affect the relative values as well, such as benefits continued to surviving spouses. These other differences will be addressed in Section 3.4 of this report.

The retirement savings amounts shown in Illustration 3.2.1 are close to those in similar studies. It may be argued that Plan E members may be less likely to save for retirement given their choice to participate in a noncontributory retirement plan. That may well be, but it was also our intent to calculate the replacement ratios in Illustration 3.2.1 using a common baseline of preretirement expenditures. If we assume that Plan E members spend the Plan D contributions rather than save them for retirement, we get the results shown in Illustration 3.2.2. Note that we assume in this illustration that they put the same amounts into the 401(k) and 457 plans as the Plan D members.

- **Many of the replacement ratios are over 100%**

  It is important to note that the benefits in Illustration 3.2.1 are both employee and County financed. Between 40% and 55% of the benefits are funded by the member, thus the County does not finance retirement benefits which exceed 100% of net preretirement earnings for a 30 year employee. The county-funded portion of the benefits at retirement are more in the range of 50% to 80% of net preretirement earnings.

- **The replacement ratios for the nonrepresented employees exceed those of the represented employees.**

  This "equity" issue is addressed in detail in Section 3.3 of this report. It is generally the result of the higher flexible benefit amounts which are included in the calculation of the Retirement System benefits.

- **The Property Agent II has an equal or lower replacement ratio than Secretary I.**

  The reason for this is the $244 monthly flexible benefit cash option under the Choices plan is relatively small compared to the Property Agent II's monthly earnings. Since the Local 660 Memorandum of Understanding provides that the cash option under the Options flexible benefit plan will become equal to that of the Choices plan in 1994, we have used the $244 monthly amount for both the Secretary I and Property Agent II. The $244 is a higher percentage of the Secretary I's pay, so the resulting pension benefit is about 3% higher as a percentage of pay. Under Plan D, this 3% difference is offset by the fact that the Property Agent II experiences a more favorable tax situation after retirement, relative to preretirement, than does the Secretary I.

Replacement Ratios and the Change in Living Expenses After Retirement

There are many factors that need to be considered when evaluating the results of the replacement ratio analysis. One of these is the change in living expenses that occurs after retirement. A discussion of how this affects a replacement ratio analysis is described in *Pension Planning* (Allen, Melone and Rosenbloom, Richard D. Irwin):

> Another reason why some reduction in gross income can be tolerated is the removal of work-related expenses such as commutation costs, the expense of maintaining a second car, lunch and clothing costs, and so on. Also, many retired individuals no longer face the costs associated with child rearing (food, clothing, education, and the like) and many will have reduced housing costs because of the completion of mortgage payments and, in some localities, reduced real estate tax rates.

A May 1980 report by the President's Commission on Pension Policy assumed in its replacement ratio analysis that the reduction in living expenses is 6% of after-tax wages.

On the other hand, some experts claim that poor health (which can lead to expenditures for custodial type care which is generally not covered by health plans) and increased leisure-related and community service activities can increase certain types of expenses over their preretirement levels.

In our opinion, the differences in expenses will vary widely among individuals. For example, the higher paid employees will have higher work related expenses. However, our preretirement income tax calculations assume that these employees take the standard deduction, which probably overstates the preretirement income taxes in the illustration and somewhat compensates for any work related expenses we might have otherwise added. For these reasons we have not incorporated any preretirement and postretirement expense differences in our analysis. However, one area of expenses which warrants further discussion is postretirement medical expenses.

Replacement Ratios and Postretirement Medical Expenses

County employees can receive medical coverage that is entirely employer-paid. Retirees with 25 or more years of service at retirement can also receive free medical plus dental and vision coverage. Therefore, no differences between preretirement and postretirement health related expenses have been factored into our analysis.

As discussed above, there may be additional health-related postretirement expenses due to deteriorating health, such as custodial care. We have assumed that these and other postretirement expenses are offset by reductions in work-related expenses.

This assumption should not minimize the attention due this item. There is a substantial financial commitment associated with continuing fully paid medical coverage for retirees. If the County has not evaluated the long term costs associated with such a commitment and established a strategy to finance it, this step should be taken.

Replacement Ratios and The Effect of Postretirement Inflation

Note that the replacement ratio analyses in Illustrations 3.2.1 and 3.2.2 provide only a snapshot of retirement income adequacy at the time of retirement. In order to maintain a person's standard of living throughout retirement, it is necessary to consider the effects of inflation. Plan D members receive an automatic 2% cost-of-living adjustment each year. Plan E members have no automatic cost of living adjustment.

Illustration 3.2.3 provides the projected replacement ratios for selected ages after retirement and a dynamic measure of adequacy called the Retirement Benefit Adequacy Coefficient (RBAC). The RBAC is determined as follows:

1. Project the replacement ratios for each age after retirement;
2. Multiply each rate by the probability that the retiree will live to that age;
3. Add up all the products calculated in step 2; and
4. Divide the result of step 3 by what would have been achieved if the replacement ratios had been 100% for each age after retirement.

The RBAC can be interpreted as the average standard of living that the retiree will experience after retirement as compared to his or her preretirement standard of living. A RBAC of less than 1.00 indicates that the retiree can expect to experience some reduction from preretirement standard of living at some point during retirement.

Illustration 3.2.3 provides the RBAC for both Plan D (without and with an ongoing STAR – the additional supplemental pay-as-you-go cost of living program provided by the Retirement System) and Plan E. Note that the STAR program protects only the Retirement System benefits from falling below 75% of original purchasing power. The percentages in Illustration 3.2.3 can still fall below 75% because the retirement savings plans have no cost-of-living protection

Results of Retirement Benefit Adequacy Analysis

Illustration 3.2.3 shows that our typical Los Angeles County employees will experience a reduction in standard of living after retirement if inflation is 5% annually (present inflation assumption used by the Retirement System). The 30 year employees used in our analysis are not retiring into a more lucrative lifestyle than they enjoyed in their working years. It is true that initial benefits are generally at or above the level necessary to sustain an equivalent lifestyle, but inflation will take its toll over the retirees' expected future lifetimes.

The adequacy analysis provides only one element of the retirement planning picture. There may be (and typically are) limited financial resources which preclude an organization from providing full standard of living protection in a retirement program. Thus the following equally important questions need to be answered:

- Are pension benefits provided by the County Retirement System equitable to all classes of our typical employee group?
- How do County benefits compare with other entities, both public and private?

The majority of this report is dedicated to answering these questions. The benefit adequacy results will be an important underpinning in the development of the answers.

Minimum Benefits Requirements

As part of our report, we were asked to comment on how the County Retirement System benefits compare with legal minimums. The Omnibus Budget Reconciliation Act of 1990 (OBRA '90) introduced minimum benefit requirements that must be met by a state or local government employer in order for the entity's employees to be excluded from Social Security coverage. The minimum benefit level is intended to approximate the benefits that would be provided by Social Security and are specified in the law based on

ILLUSTRATION 3.2.3

SPENDABLE INCOME ANALYSIS OF TYPICAL EMPLOYEES

SECRETARY I

Age	Plan D (w/o STAR)	Plan D (w/STAR)	Plan E
62	86%	86%	102%
65	79%	80%	89%
70	68%	68%	70%
75	58%	64%	55%
80	49%	63%	43%
85	42%	62%	34%
90	36%	61%	26%
Adequacy Coefficient	0.61	0.69	0.62

DP MANAGER I

Age	Plan D (w/o STAR)	Plan D (w/STAR)	Plan E
62	113%	113%	124%
65	102%	103%	107%
70	86%	86%	84%
75	72%	83%	66%
80	61%	79%	52%
85	51%	77%	40%
90	43%	74%	32%
Adequacy Coefficient	0.78	0.88	0.75

PROPERTY AGENT II

Age	Plan D (w/o STAR)	Plan D (w/STAR)	Plan E
62	86%	86%	99%
65	79%	79%	86%
70	67%	67%	68%
75	57%	64%	53%
80	49%	63%	42%
85	42%	62%	33%
90	36%	61%	26%
Adequacy Coefficient	0.61	0.68	0.60

DP MANAGER III

Age	Plan D (w/o STAR)	Plan D (w/STAR)	Plan E
62	118%	118%	128%
65	106%	107%	111%
70	90%	90%	87%
75	75%	86%	68%
80	63%	83%	53%
85	53%	80%	42%
90	45%	78%	33%
Adequacy Coefficient	0.81	0.92	0.77

SR SECRETARY III

Age	Plan D (w/o STAR)	Plan D (w/STAR)	Plan E
62	107%	107%	124%
65	97%	98%	108%
70	82%	82%	84%
75	69%	78%	66%
80	58%	76%	52%
85	49%	74%	41%
90	42%	72%	32%
Adequacy Coefficient	0.74	0.84	0.75

AUDITOR CONTROLLER

Age	Plan D (w/o STAR)	Plan D (w/STAR)	Plan E
62	112%	112%	119%
65	102%	102%	103%
70	86%	86%	81%
75	72%	82%	63%
80	61%	80%	50%
85	52%	78%	39%
90	44%	76%	30%
Adequacy Coefficient	0.78	0.88	0.72

Illustration 3.2.4

Los Angeles County Retirement System Benefit Percentages vs. OBRA '90 Minimum Benefits

Typical Employee	Monthly Pensionable Earnings		Benefits Expressed as a Percentage of LA County Pensionable Earnings (2)		
	LA County	OBRA '90 (1)	Plan D	Plan E	OBRA '90
Secretary I	$2,558	$2,230	72.97%	60.00%	40.18%
Property Agent II	4,168	3,844	72.97%	60.00%	42.49%
Sr Secretary III	3,558	2,984	72.97%	60.00%	38.51%
DP Manager I	7,234	4,625	72.97%	60.00%	29.70%
DP Manager III	9,699	4,625	72.97%	60.00%	22.17%
Auditor Controller	13,717	4,625	72.97%	60.00%	15.68%

(1) Base salary limited to $55,500 in 1992.
(2) Based on age 65 retirement with 30 years of service

a retirement age of 65. Illustration 3.2.4 provides a comparison of the minimum benefits for pension plans with those provided under Plans D and E.

Illustration 3.2.4 indicates that both Plans D and E well exceed these minimum pension benefit requirements.

Note that the retirement benefit percentages in this illustration are different than those shown in Illustrations 3.2.1 and 3.2.2 since these represent the percentage of gross pensionable earnings provided under the Retirement System alone, and do not reflect the effect of taxes and the change in living expenses after retirement.

It should be noted in the context of OBRA '90, the minimum benefit rules can be satisfied by providing benefits in forms other than pension plans. In fact, part time, seasonal and temporary County employees not covered by the County Retirement System are covered by the County's Pension Savings Program. This program, which is funded entirely by employee contributions equal to 3% of pay, is provided in the form of a Section 457 savings plan. This program (which is obviously very cost effective for the county) also meets the minimum benefit requirements under OBRA '90 even though it is entirely employee funded. For this reason, it is probably not very meaningful to use these rules as a measure of adequacy.

3.3
INTRA-COUNTY COMPARISON — EQUITY ELEMENT

KEY POINTS

This section of the report deals with the following question:

Is the County retirement program equitable to all classes of our typical employee group?

Our equity measure is based upon the Retirement Benefit Adequacy Coefficient (RBAC) developed in Section 3.2

- As measured by the RBAC, the typical employees in the Choices and the Options flexible benefits plans receive less adequate retirement benefits than the typical employees who participate in the MegaFlex plan. This is the direct result of the level of flexible benefit cash options included as pensionable earnings.
- The results of equity tests among the typical employees who participate in the MegaFlex plan indicate a bias towards highly compensated employees (based on the IRS definition of "highly compensated employees"). The desirability of this situation is a compensation and benefit policy issue.
- The Commission may want to recommend further study of executive compensation and benefits issues as they relate to public and private sector employees.

Plans Considered

In this discussion we are not concerning ourselves with considerations of equity *among* the five plans of benefits that exist within the Retirement System. We would not expect benefits among these various plans to be comparable. In W F Corroon's 1991 Retirement Benefits Survey we compared the actuarial present values of the retirement benefits received by a typical employee from Plans A through E (Plan D=1.00). Illustration 3.3.1 shows this comparison.

Illustration 3.3.1

Plan	Relative Value (1)	Member Contribution Rate (2)
A	1.44	5.82%
B	1.13	8.16%
C	1.00	7.30%
D	1.00	7.31%
E	0.57	0.00%

1. Combined value of employee and employer financed benefit.
2. Contribution rate for a member entering the plan at age 32 who is not covered by Social Security.

The decreases in relative value are design-based. By that we mean they were negotiated and installed as part of an ongoing process of reducing retirement benefit costs for succeeding generations of new County employees. When cost-reducing plan design changes were implemented, the state and federal constitutional protection against reducing benefits for existing employees led to the closing of Plans A, B, and C. This naturally created inequities such as those shown in Illustration 3.3.1.

Our focus in this study will be on equity issues among our group of typical employees within a common generation, that is, within the same plan of benefits.

Equity Measure

Definition of Equity Measure

The first issue that needs to be addressed is how we will define our equity measure.

The Retirement Benefit Adequacy Coefficient (RBAC) was introduced in Section 3.2. It represents the average standard of living that will be experienced by the retiree over his or her retirement years in relation to that experienced before retirement. A RBAC of less than 1.00 indicates that, on the average, the retiree will experience a reduction in standard of living. The RBAC's of our typical employees can be compared and used as a measure of equity among members of the groups.

Before we use the RBAC as an equity measure, we need to distill the various pieces that we are trying to measure. In Section 3.2 of this report we incorporated within the RBAC the value of all retirement income benefits, regardless of whether they were funded by the employee or the employer. For purposes of measuring equity, rather than adequacy, we should remove the employee funded benefits. Also, we will ignore the STAR supplemental cost-of-living program, since the source of funding is retirement fund earnings rather than member and County contributions. Also, there is no guarantee that this program will continue for the indefinite future. Elimination of STAR from the RBAC should not have any significant impact on the results.

Application of the RBAC Equity Tests

In order to determine whether equity exists among specific groups of employees, we have distinguished between:

- The Options/Choices flexible benefits plan participants and the MegaFlex participants; and
- Nonhighly versus highly compensated employees in the MegaFlex plan

We have broken the MegaFlex group into "non-highly-compensated" and "highly compensated employees" based upon the IRS's 1992 pay breakpoint of $62,345. The IRS has detailed nondiscrimination testing rules to ensure that retirement plans do not favor highly compensated employees. These rules do not yet apply to state and local government retirement plans, but this pay breakpoint will be useful for our equity measurement purposes as an established fine line for identifying highly compensated employees.

Results of RBAC Equity Tests

Illustration 3.3.2 provides the modified RBACs for the group of typical employees. Following are our conclusions.

1. We see a sharp contrast in the RBAC's between employees, depending upon whether they participate in the Options or Choices flex plans versus the MegaFlex plan. This is the direct result of including the flexible benefit cash options and transportation allowances in pensionable earnings. The Choices and Options employees receive a smaller benefit increase from this inclusion than do MegaFlex participants due to the magnitude of the MegaFlex credits as a percentage of salary (17%) versus the cash options available under the Choices Plan and Options Plan. Since the MegaFlex Plan is only offered to nonrepresented employees, this may create collective bargaining pressure.

Illustration 3.3.2

Determination of Retirement Income Equity

Typical Employee	Monthly Gross Preretirement Income	Monthly Pensionable Earnings	County Funded Portion of Retirement Benefit Adequacy Coefficient (RBAC): Plan D	Plan E
Options and Choices Flexible Benefits				
Nonhighly Compensated Employees				
Secretary I	$2,337	$2,558	0.37	0.35
Property Agent II	3,962	4,168	0.37	0.34
MegaFlex Flexible Benefits				
Nonhighly Compensated Employees				
Sr Secretary III	3,079	3,558	0.45	0.44
Highly Compensated Employees				
DP Manager I	6,189	7,234	0.49	0.44
DP Manager III	7,854	9,699	0.54	0.49
Auditor Controller	11,275	13,717	0.57	0.51

Retirement Benefit Adequacy Coefficient (RBAC) includes the employer funded portion of both pension and retirement savings plans, and excludes the value of STAR and the employee funded portion of benefits.

2. The higher dependence on income from savings plans under Plan E (which are less advantageous for highly compensated employees) keeps the typical highly compensated employees' RBACs close to those of the nonhighly compensated, nonrepresented employees.

3. The results for both Plan D and Plan E participants indicate a bias towards the highly compensated employees. This raises the policy question of whether or not it is appropriate that the County's overall retirement program should provide a more adequate benefit for its highly compensated versus its nonhighly compensated and bargained employees.

This policy question must be considered carefully. There may be very good reasons to tilt benefits somewhat toward the higher paid. The attraction and retention of highly qualified executive level employees is difficult for public entities due to strict limitations on the types of executive compensation and benefit programs available to governmental employees. Executives in the private sector are likely to be provided with other compensation and benefits such as stock related compensation (options, appreciation rights, restricted grants, etc.), nonqualified tax deferred savings plans and supplemental retirement programs. On the other hand, there are stockholder moves afoot to cut back on executive compensation and benefit packages in at least some private sector organizations.

The evaluation of executive compensation and benefits issues as they relate to public and private sector employees is beyond the scope of our study. The Commission may want to recommend that this issue be studied further.

3.4
COMPETITIVE ELEMENT

KEY POINTS

This section of the report deals with the following question:

How competitive are County benefits when compared with other entities, both public and private?

- When viewed in the aggregate, Los Angeles County provides retirement income plans comparable to those available to the 17 other employers surveyed.
- In comparing the forms of compensation includable in pensionable earnings, Los Angeles County is unique among those surveyed for including transportation allowance, security allowance, and county flexible benefit contributions. However, survey data provided to us by the Commission indicated that some of the smaller 1937 Act retirement systems include these items in pensionable earnings.

In order to evaluate the competitive element, we surveyed 5 of the 10 largest corporations with headquarters in Los Angeles County, 2 California public utilities, and 10 other California public retirement systems and compared the retirement benefits with those available to Los Angeles County employees. The public retirement systems survey included four of the largest 1937 Act systems, the two largest CalPERS counties, the two largest city systems, and the state employees covered under CalPERS We have included retirement income from the following sources:

- Pension plan;
- Defined contribution plan including IRS Sections 401(k) and 457 plans;
- Social Security benefits; and
- Other retirement income, such as an Employee Stock Ownership Plan (ESOP).

Our survey revealed the following results:

- 78% or 14 of the 18 surveyed are covered by social security.

ILLUSTRATION 3.4.1

SURVEY OF RETIREMENT PROGRAMS

Employer	Social Security	Pension Plan	Retirement Savings		Other Retirement Plans
			401(k) Plan	457 Plan	
Los Angeles County	No	Yes	Yes	Yes	No
Public - 1	Yes	Yes	No	Yes	No
Public - 2	No	Yes	No	Yes	No
Public - 3	Yes	Yes	No	Yes	No
Public - 4	Yes	Yes	No	Yes	No
Public - 5	Yes	Yes	Yes	Yes	No
Public - 6	Yes	Yes	No	Yes	No
Public - 7	Yes	Yes	No	Yes	No
Public - 8	No	Yes	No	Yes	No
Public - 9	No	Yes	No	Yes	No
Public - 10	Yes	Yes	No	Yes	No
Utility - 1	Yes	Yes	Yes	No	No
Utility - 2	Yes	Yes	Yes	No	No
Corp - 1	Yes	Yes	Yes	No	Yes
Corp - 2	Yes	Yes	Yes	No	Yes
Corp - 3	Yes	Yes	Yes	No	No
Corp - 4	Yes	No	Yes	No	Yes
Corp - 5	Yes	Yes	Yes	No	No
Yes	14	17	9	11	3
No	4	1	9	7	15

- 94% or 17 of the 18 surveyed have a pension plan.
- 100% or 18 of the 18 surveyed have at least one defined contribution plan.
- 17% or 3 of the 18 surveyed have some other retirement income plan.

Determination of Relative Value of Retirement Programs

In order to determine the relative values of the benefits provided under the retirement programs of our typical employers we:

- In effect, transport the typical employee group into each of the surveyed employer's retirement programs;
- Have them contribute to the available pension and retirement savings plans (and Social Security, if applicable) to the same extent they are contributing under the Los Angeles retirement program;
- Determine the value of the total retirement benefits they would derive under each of the employer's plans
- Compare the derived values with those of Los Angeles Plan D.

This approach allows us to compare the program's relative value for each of the typical employees.

Pension Plans

Generally, a pension plan defines a formula to determine the monthly benefit that will be paid to a retiree during retirement. The formulas in most cases are a function of years of employment, salary, and the age at retirement.

It should be noted that the majority of the public employers surveyed **require employees** to contribute to the pension plan. On the contrary, the private employers included in our survey have no such requirement. Of the 10 public employers surveyed 3 currently do not require any employee contributions for either all or some of their employees. Los Angeles County is the only employer of those surveyed which offers an option of a contributory or noncontributory pension plans (Plan D or E) to its employees. This type of an option is also available from other California public employers not included in this survey.

Pensionable Earnings

Each of the plans surveyed has a specific definition of earnings which is used to determine pension benefits. For those employers surveyed, the definition ranges from base pay to W2 wages. We polled the employers on the various compensation elements included in determining the amount of pension benefits. The forms of compensation surveyed were:

- Base compensation
- Overtime
- Shift differentials
- Bonus (1)
- Flexible benefits (2)
- Transportation allowance
- Security allowance
- Other skill related compensation, such as bilingual pay
- Salary deferrals included in the year received
- Arrangements where the employer pays the employee contributions and the employee contributions are included as pensionable earnings (Employer Pickup).

The results of this poll for the 17 employers with a pension plan reveal the following:

- Only 2 of the 5 corporate employers and none of the public employers or utilities include overtime in pensionable earnings.
- 13 of the 17 employers include some shift differentials in pensionable earnings.
- 10 of the 17 employers include bonuses (1).

(1) Includable amounts may be limited to certain types of bonuses.

(2) All employee salary reduction contributions are includable pensionable earnings. This refers to the cash option available, if any.

- Only 1 of the 17 employers includes transportation allowance, security allowance, and flexible benefits [2].
- 10 of the 17 employers include skill related compensation, such as bilingual pay.
- 2 of the 11 public pension plans include the employer pickup of employee contributions in pensionable earnings.

Cost of Living Adjustments (COLA)

Inflation can rapidly erode the value of a pension. The automatic COLA plays an important role in maintaining the retiree's standard of living by restoring at least part of the purchasing power lost through inflation. Many of the public retirement plans provide automatic COLA tied to on the Consumer Price Index with some maximum limitation on the annual adjustment (usually 2% or 3%). It should be noted that while some plans do not have an automatic COLA, they do provide ad hoc increases for retirees and other supplemental benefits.

The COLA has significant value for a retiree. In Illustration 3.4.3 we show a comparison of a $100 monthly benefit with the same $100 benefit with a 2% COLA and then fully adjusted for inflation (5% per annum).

[2] All employee salary reduction contributions are includable pensionable earnings. This refers to the cash option available, if any.

Illustration 3.4.2

Survey of Pensionable Earnings

Employer	Monthly Base Salary	Overtime	Shift Differentials	Bonus	Flexible Benefits Plan	Transportation Allowance	Security Allowance	Skill Related Compensation (e.g. Bilingual Pay)	Salary Deferral	Employer Pickup
Los Angeles County	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	No	No
Public - 1	Yes	No	Yes	No	No	No	No	Yes	No	No
Public - 2	Yes	No	No	No	No	No	No	No	No	No
Public - 3	Yes	No	Yes	No	No	No	No	Yes	No	No
Public - 4	Yes	No	Yes	No	No	No	No	Yes	No	No
Public - 5	Yes	No	Yes	Yes	No	No	No	Yes	No	No
Public - 6	Yes	No	Yes	Yes	No	No	No	Yes	No	Yes
Public - 7	Yes	No	Yes	Yes	No	No	No	Yes	No	Yes
Public - 8	Yes	No	Yes	Yes	No	No	No	Yes	No	No
Public - 9	Yes	No	Yes	Yes	No	No	No	Yes	No	No
Public - 10	Yes	No	Yes	Yes	No	No	No	Yes	No	No
Utility - 1	Yes	No	Yes	Yes	No	No	No	No	No	N/A
Utility - 2	Yes	No	No	No	No	No	No	No	No	N/A
Corp - 1	Yes	No	No	No	No	No	No	No	No	N/A
Corp - 2	Yes	Yes	Yes	Yes	No	No	No	No	No	N/A
Corp - 3	Yes	Yes	Yes	Yes	No	No	No	No	No	N/A
Corp - 4	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Corp - 5	Yes	No	No	No	No	No	No	No	No	N/A
Yes	17	2	13	10	1	1	1	10	0	2
No	0	15	4	7	16	16	16	7	17	9
(Not Applicable)	1	1	1	1	1	1	1	1	1	7
Total Responses	18	18	18	18	18	18	18	18	18	18

Our survey of pension plans reveals the following information:

- 9 of the 10 public pension plans have COLA provisions which provide either a maximum 2% or 3% COLA each year. (Los Angeles Plan D has a 2% COLA and Plan E has none.)
- 1 of the 2 utilities consistently provides an ad hoc COLA anticipated to average 2% per year.
- None of the corporate pension plans have automatic COLA provisions or a policy of consistent ad hoc COLAs.

Survivor Benefits

The pension benefit is typically paid to a retiree during his or her lifetime. All of public plans surveyed provide either a 60% or 50% continuance to the member's eligible surviving spouse upon the member's death after retirement **at no additional cost** to the retiree. While the surveyed corporate plans are required under the Employee Retirement Income Security Act (ERISA) to provide a 50% continuance to a spouse, they require the retiree to pay for it by reducing the amount otherwise payable during the retiree's lifetime.

Valuation Methodology

The relative values of the surveyed plans were determined by calculating the present value of the pension benefits provided under each employer's pension plan for our typical employees using the assumptions in Illustration 3.4.4 and the age and service profile in Illustration 3.4.5. This present value reflects:

- The definition of pensionable earnings
- COLAs
- Survivor benefits provided to the retiree at no additional cost

Retirement Savings Plans

Included in our comparison of retirement programs are retirement savings plans. These include:

- Section 457 Plans

  These retirement savings plans are generally made available by state and local government employers. A 457 Plan allows employee and employer contributions up to a maximum dollar amount of $7,500. This maximum dollar amount is currently fixed. This type of plan also has a catch-up provision which allows an employee to defer up to $15,000 during the 3 years prior to retirement.

- Section 401(k) Plans

  These plans are very common in the private sector. A 401(k) plan allows an employee to defer taxable income up to a maximum dollar amount

Illustration 3.4.3

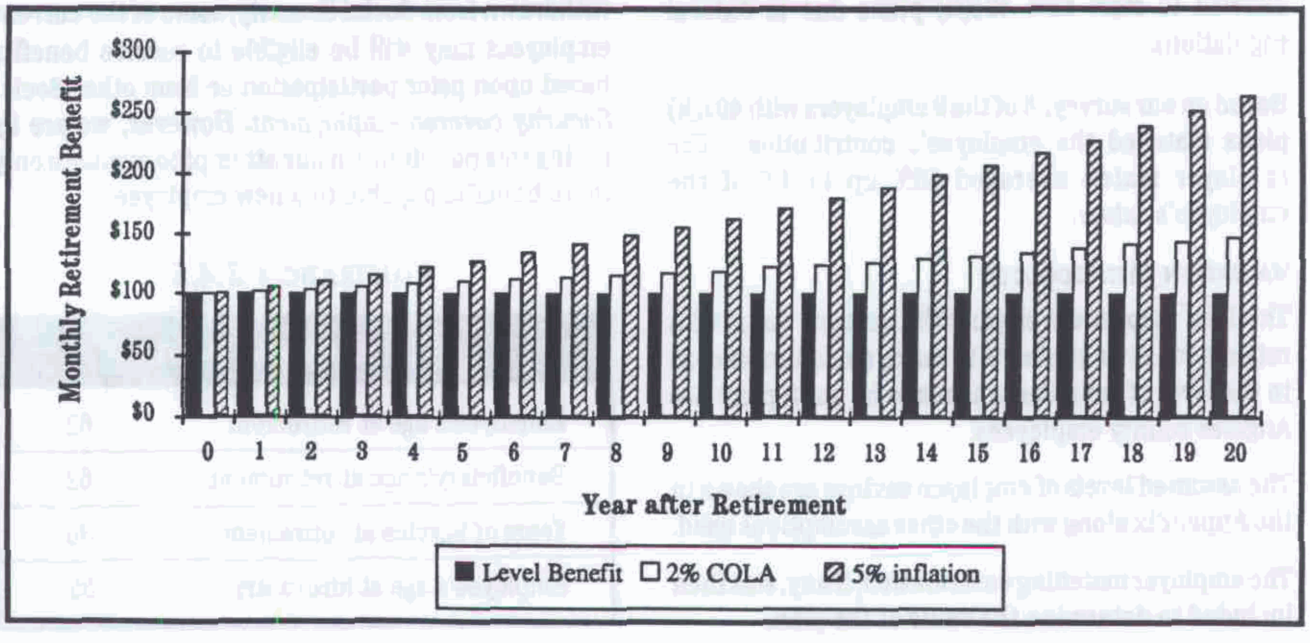


ILLUSTRATION 3.4.4

ACTUARIAL ASSUMPTIONS		
Interest rate	8%/year	
Backward salary scale*	6%/year	(includes 5% for inflation and 1% for promotion)
Inflation	5%/year	
Social Security future CPI increases	5%/year	
Mortality	1971 Group Annuity Male Mortality setback 5 years to reflect a unisex basis	
Percentage Married	70%	

* For our typical DP Managers I and III, and Auditor Controller we used a 6% backward salary scale per year for the last 5 years and 9% for the earlier years for the Auditor Controller, 7.5% for DP Manager III, and 6.7% for DP Manager I.

of $8,728 during 1992. The maximum dollar amount is adjusted annually to reflect inflation.

All of the public employers surveyed, have an Internal Revenue Code (IRC) Section 457 plan. Los Angeles County is the only employer in the survey that provides a plan with a matching employer contribution.

Of the survey participants, all private employers and 2 public employers provided IRC Section 401(k) plans. It should be noted that public employers are no longer allowed to start new 401(k) plans due to federal regulations.

Based on our survey, 8 of the 9 employers with 401(k) plans matched the employee's contribution. The employer match averaged 66% up to 4% of the employee's salary.

VALUATION METHODOLOGY

The first step in developing the relative value of a retirement savings plan is to make an assumption as to the level of contributions made by our typical Los Angeles county employees.

The assumed levels of employee savings are shown in the Appendix along with the other assumptions used.

The employer matching contribution, if any, was then included to determine the value of the plan.

SOCIAL SECURITY

For those employers that provide Social Security coverage for their employees, the value was included in our process. The Social Security benefit was determined as the amount available at age 62 under current Social Security law assuming the typical employee participated in Social Security throughout his or her entire career.

Note that because some of the public employers have withdrawn from Social Security, some of the current employees may still be eligible to receive benefits based upon prior participation or from other Social Security covered employment. However, we are ignoring this possibility in our attempt to evaluate only those benefits payable to a new employee.

ILLUSTRATION 3.4.5

TYPICAL EMPLOYEE PROFILE	
Employee's age at retirement	62
Beneficiary's age at retirement	62
Years of Service at retirement	30
Employee's age at hire/entry	32

Valuation Methodology

The method of determining the value of Social Security coverage is similar to that used for pension plans.

Other Retirement Plans

Other types of employer-funded retirement plans were offered by some of the surveyed private employers

Valuation Methodology

The method of determining the value of these plans was similar to that used for the retirement savings plans. We have assumed a net investment earning of 8% per year during our typical employee's career.

Relative Values

The results of our relative value analysis are shown in Illustrations 3.4.6 and 3.4.7. Illustration 3.4.6 shows the averages from Illustration 3.4.7. The numerical relative values can be found in the Appendix. We have given each employer's program a value for each typical employee relative to that of the same employee participating in Los Angeles Plan D. If employer X has a value of 1.15, employer X has a 15% higher value than Plan D. Similarly, if employer Z has a value of .80, plan Z has a value that is 20% less than Plan D.

The conclusions from our comparative analysis are:

- Public Employers

  Benefits for the Secretary I and Property Agent II are at the lower end of the range when compared to those of other public employers. As we move into the nonrepresented group the effect of adding MegaFlex amounts raises the relative values of the Los Angeles employees considerably. The Sr. Secretary III is near the average and the DP Manager I climbs to the upper end of the range. The Plan E and Plan D values diverge for the DP Manager III and the Auditor Controller. The Plan D values are just below the top of the range and Plan E values fall back close to the average.

- Public Utilities

  The relative values for the sample public utilities are very similar to those of the public entities. Thus the public employer comparisons apply here as well.

- Corporation

  The sample corporate plans provide benefits with values below those of Los Angeles, with the exception of the Secretary I and Property Agent II. The differences are attributable to a number of causes, including:

Illustration 3.4.6

Relatives Values

			Averages of Surveyed Employers		
Job Title	Plan D	Plan E	10 Public	2 Utilities	5 Corporations
Secretary I	1.00	0.97	1.11	1.10	1.02
Property Agent II	1.00	1.00	1.12	1.09	0.97
Sr Secretary III	1.00	1.02	1.01	1.05	0.96
DP Manager I	1.00	1.03	0.90	0.96	0.93
DP Manager III	1.00	0.91	0.89	0.89	0.84
Auditor Controller	1.00	0.86	0.88	0.85	0.80

ILLUSTRATION 3.4.7

RELATIVE VALUES FOR TYPICAL EMPLOYEES

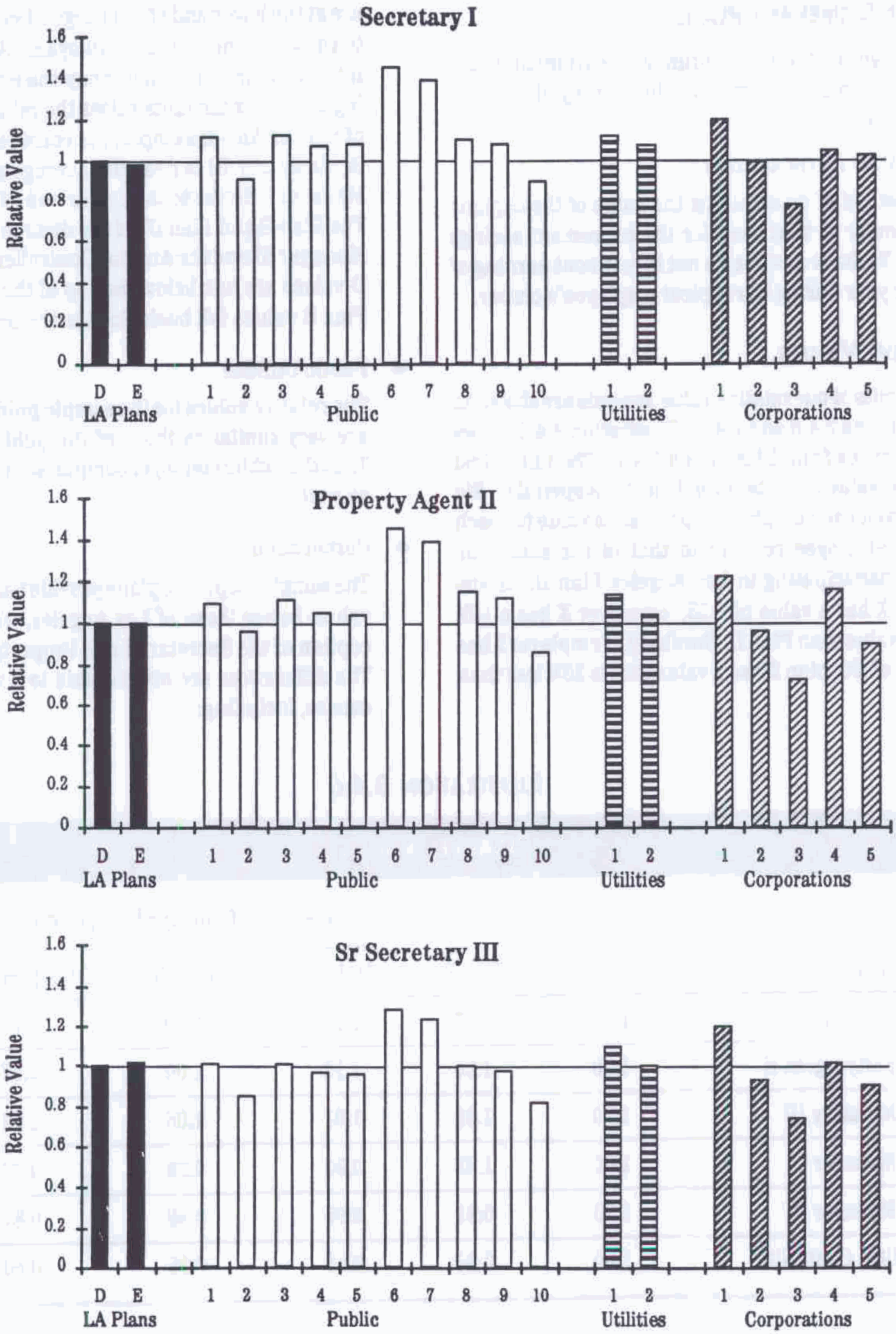
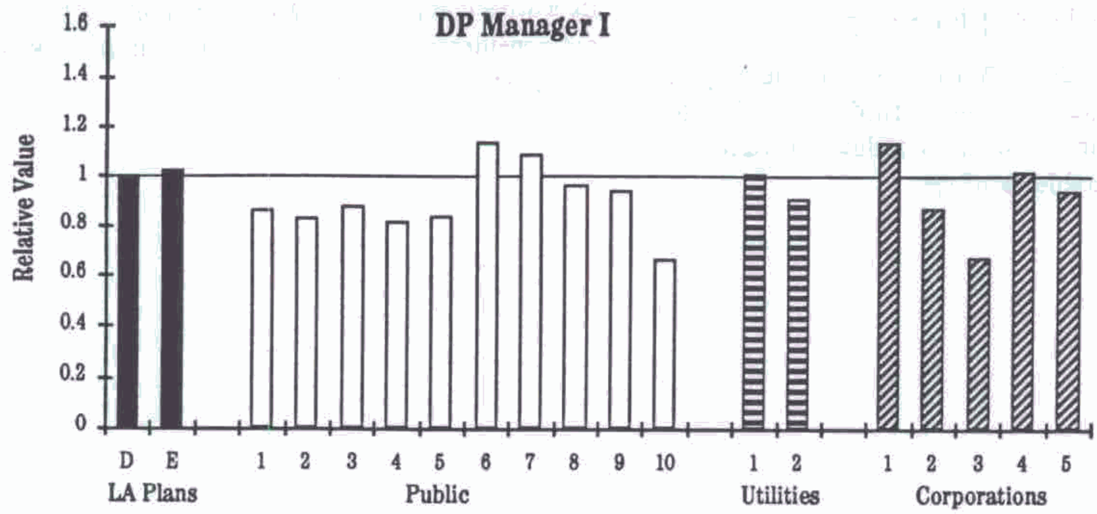
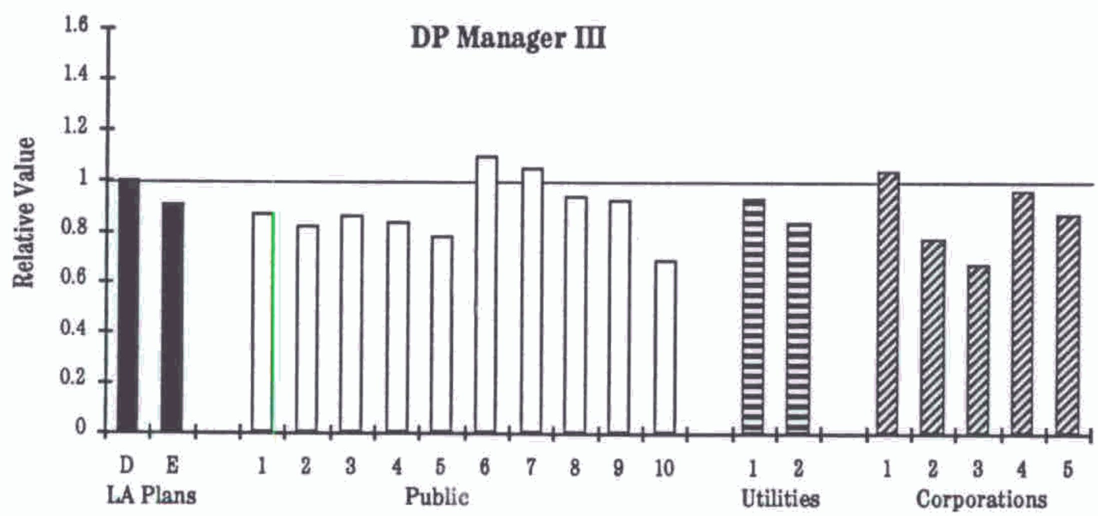
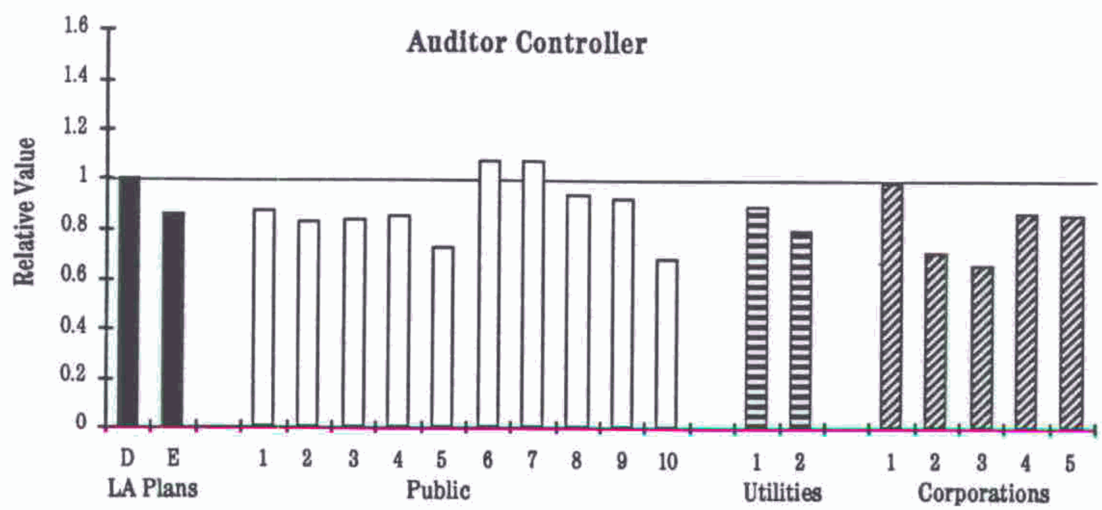


ILLUSTRATION 3.4.7

RELATIVE VALUES FOR TYPICAL EMPLOYEES







1. Social Security – Social Security benefits provided higher replacement ratios for lower paid employees. This will tend to reduce the value for the higher paid employees versus those of Los Angeles county.
2. Pensionable earnings – None of the corporations include employer flexible benefits contributions or transportation allowances in pensionable earnings.
3. Absence of COLAs – None of the corporate plans have automatic COLA provisions or a policy of consistent ad hoc COLAs.

Executive compensation and benefit programs were not considered. This should be kept in mind when interpreting the results.

3.5
FUNDING/ACTUARIAL ISSUES – FINANCING ELEMENT

KEY POINTS

This section of the report deals with the following question:

Are the Retirement System benefits being funded in a reasonable and a responsible manner considering the increases in liabilities that have occurred as a result of the inclusion of flexible benefit cash options and other additional compensation elements into pensionable compensation?

- Though contribution levels have been increased, the funded status of the system remains sound.
- There was a decrease in the government accounting standard funding ratio from 84.9% as of June 30, 1990 to 81.5% as of June 30, 1991. Even with this reduction, the Los Angeles County system's funded ratio is above that of the median county retirement system, and sits very close to the average for all these systems.
- Actuarial Assumptions

  In general we found the actuarial assumptions used by the Retirement System to be reasonable and consistent with those used by other 1937 Act county retirement systems. There are three specific items we would comment on:

  - Options Flexible Benefit Plan

    An additional increase in unfunded liability will occur when flexible benefit cash options attributable to the Options plan, first effective in 1992, are included in actuarial calculations.

  - Population Growth Assumption

    We recommend that the Board of Investments review the appropriateness of the 1% growth assumption when the amortization period is reevaluated in four years.

- Future Flexible Benefits Amounts under Choices

  It was assumed in the actuarial valuation that the cash option available under the Choices plan will increase at the same rate as future salaries, i.e., 6% per year. If it increases more rapidly than this (e.g., if it increases in unison with increases in medical premiums under the Choices plan) there will be substantial future increases in the unfunded liability.

  This is an area where there is need for close coordination between County administration and the Retirement System so that all parties are acutely aware of the retirement cost implications of future negotiated cash options available under the Choices plan. These same concerns will also apply to the cash option under the Options Flexible Benefits Plan.

◆ Fiscal Management Policies

Government Code Section 7507 requires that actuarial studies to determine future annual costs be carried out by "local legislative bodies" before authorizing increases in public retirement plan benefits. This legal requirement should not be the sole guide to responsible fiscal management of retirement benefit costs. The County management must maintain a consistent policy of formally communicating with the Retirement System Boards and staff to be sure that retirement cost implications of their actions are evaluated before they are instituted.

◆ STAR Program

Future costs of continuing this program will increase because of the inclusion of the additional compensation elements in pensionable earnings.

Evaluation of Funding Condition and Financing Methodology

As part of our study we examined the most recent actuarial reports to determine the degree to which the additional liabilities have affected the System's funding status and contribution levels.

In the simplest terms, there are two measures which can be used to evaluate the funding status:

1. **GASB Funding Ratio**

   The Governmental Accounting Standards Board (GASB) in its Statement No. 5 established a universal measure of target assets against which the actual assets of a governmental retirement system are compared to determine its funding condition relative to other systems. A ratio of 100% indicates that the system has achieved its target value of assets. We can compare the Los Angeles County Retirement System GASB funded ratio with those of other 1937 Act county systems to determine its general reasonableness, since these systems all operate under comparable conditions.

2. **Actuarial Accrued Liability Ratio**

   Every funded retirement system adopts an actuarial methodology to finance its long term obligations. The retirement board has the responsibility to adopt this "funding policy". As part of this funding policy the system establishes its own target level of assets called the actuarial accrued liability. If the actuarial assets are less than the actuarial accrued liability, the system has an unfunded actuarial accrued liability. It is therefore possible to determine a funded ratio equal to the system's actuarial assets as a percentage of the actuarial accrued liability. A ratio of 100% indicates that the system has no unfunded actuarial accrued liability. The System would be expected to achieve the 100% funding ratio at the end of the amortization period adopted by the Board for amortizing unfunded liabilities. This period is currently 30 years, but will be reviewed by the Board of Investments in four years.

Results of the Evaluation

1. **GASB Funding Ratio**

   There was a decrease in the GASB Funding ratio from 84.9% as of June 30, 1990 to 81.5% as of June 30, 1991. The actuarial report attributed this decrease to "the significant increase in active member payroll" which refers to the inclusion of additional compensation elements into pensionable earnings. Illustration 3.5.1 provides a comparison of the GASB funded ratios among the 1937 Act county retirement systems. It shows that even with this reduction the Los Angeles County system's GASB funded ratio is above that of the median county retirement system, and sits very close to the average for all these systems.

2. **Actuarial Accrued Liability Ratio**

   The system's funded ratio on this basis went from 87.6% as of June 30, 1990 to 85.5% as of June 30, 1991. This decrease is primarily the result of the inclusion of flexible benefit values into pensionable earnings. The resulting increase in unfunded actuarial accrued liability was $265 million.

3. **Contribution Levels**

   Required employer contribution levels must be increased to pay off the additional unfunded liabilities over a 30-year amortization period. In addition, the ongoing costs will increase because of the higher pensionable earnings.

4. **Review of Assumptions**

   We have reviewed the assumptions used by the Retirement System's actuary to determine the funding ratios, unfunded liabilities and contributions to the System. In general we found these assumptions to be reasonable and consistent with those used by other 1937 Act county retirement systems. There are three specific items we would comment on:

   - **Options Plan**

     Since it became effective during 1992, the impact of including the cash option amount under the Options flexible benefits plan in pensionable earnings is not reflected in the System's current actuarial valuation. This plan covers approximately 40,000 members of SEIU Local 660. Cash amounts available for all bargaining units covered by the Options plan will be the same as those under the Choices plan by 1994.

- **Population Growth Assumption**

  Implicit in the determination of the contribution to the unfunded liability is an assumption that there will be a 1% annual growth in the number of Retirement System members. This has been a reasonable assumption retrospectively (membership has increased an average of 3% per year over the last three years) but may not be as reasonable going forward for thirty years. If the growth does not materialize, the contribution rate (as a percentage of payroll) will tend to climb. Most 1937 Act systems assume that the number of members will remain constant over the amortization period. If the no growth assumption was used, the 30-year amortization contribution to the unfunded liability (currently 5.13% of payroll for General Members) would be some 13% higher than under the 1% growth assumption.

  We would recommend that the Board of Investments review the appropriateness of the 1% growth assumption when the amortization period issue is revisited by the Board of Investments in four years.

- **Future Flexible Benefits Amounts under Choices Plan**

  The inclusion of the cash option amount under the Choices flexible benefits plan into pensionable earnings resulted in $162 million of the $265 million total increase in the unfunded liability. The $244 monthly cash option available under the Choices plan is currently set equal to what the County will contribute for an employee who elects single party medical coverage. It is our understanding that, for the actuarial valuation, it was assumed that this amount will increase at the same rate as future salaries, i.e., 6% per year. If the $244 amount increases more rapidly than this (e.g., if it increases in unison with increases in medical premiums under the Choices plan) there will be substantial future increases in the unfunded liability.

  This is an area where there is need for close coordination between the County administration and the Retirement System so that all parties are acutely aware of the retirement cost implications of future negotiated cash options available under the Choices plan.

Other Financial/Actuarial Issues

The following items are worthy of comment:

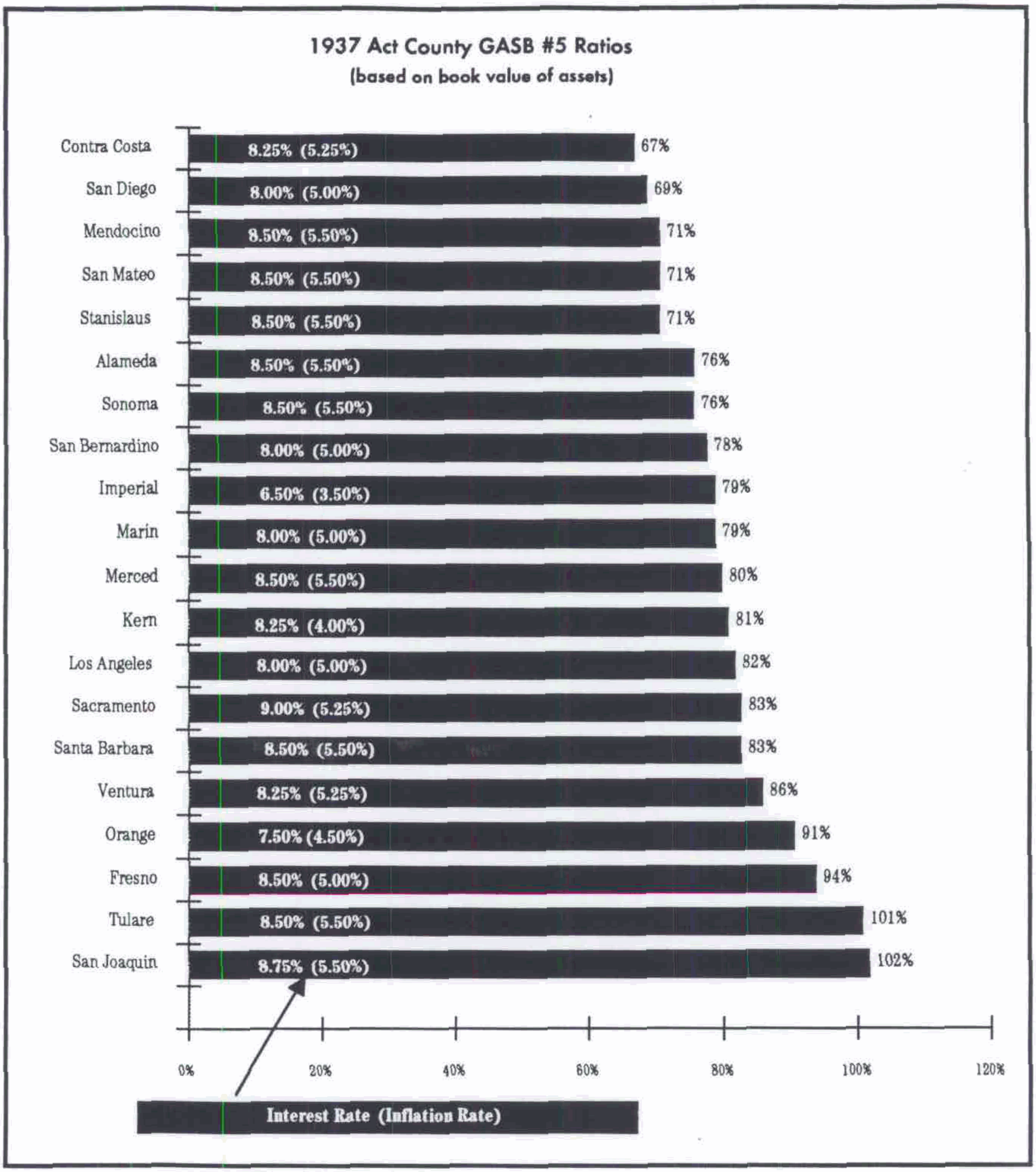
1. **Fiscal Management Policies**

   Government Code Section 7507 requires that actuarial studies to determine future annual costs be carried out by "local legislative bodies" before authorizing increases in public retirement plan benefits. We have been provided by the Commission with legal opinions which indicate that Section 7507 may very well not require an actuarial study in a case where the increases in retirement benefits occur as a result of increases in compensation. If this is true, it points out a deficiency in the law. Regardless of whether Section 7507 applies in this case, it is only a legal requirement. It should not be the sole guide to responsible fiscal management of retirement benefit costs. The County management must maintain a consistent policy of communicating formally with the Retirement System Boards and staff to be sure that retirement cost implications of their actions are evaluated before they are instituted.

2. **STAR Program**

   In 1989 the Board of Retirement implemented the STAR supplemental cost-of-living program which is designed to restore lost purchasing power of current retirees to a level equal to 75% of the purchasing power they held when their benefits began. This program is financed on a pay as you

ILLUSTRATION 3.5.1



go basis from unanticipated gains from investment earnings on the retirement fund. If this program is continued for future retirees whose retirement benefits have been increased from the inclusion of the additional compensation elements, additional amounts will be necessary to restore the lost purchasing power on these increased benefits.

Conclusions and Recommendations

Basis Upon Which Recommendations Are Developed

The core conclusions upon which our recommendations have been developed are:

- Retirement Benefit Adequacy

  In general, the benefits are not overly generous when one considers that a substantial portion of the benefit is funded by the employee, and the reduction in benefit adequacy that occurs through the inflationary losses in purchasing power after retirement.

- Retirement Benefit Equity Among Employees

  Using our typical employee group as a basis for comparison, County funded retirement benefits are more adequate for the employees participating in the MegaFlex plan. Within the MegaFlex covered group, County funded retirement benefits are more adequate for the highly compensated employees.

- Competitiveness of Los Angeles County Retirement Program with Comparable Public and Private Employers' Programs

  In general, the programs are comparable with the exception of benefits provided to highly compensated employees. This is the direct result of the inclusion of compensation elements such as County contributions toward the flexible benefit plan and transportation allowances into pensionable earnings. These items are not used by any other employers in our sample.

- Financing Element

  The additional compensation elements that have been introduced into pensionable earnings have resulted in an increase in the unfunded liability of $265 million. This does not include the effect of the Options flexible benefit plan implemented for Local 660 members earlier this year. There are potentially added future costs that may result from the continuation of the STAR supplemental cost of living program for future retirees. The additional unfunded liability has been determined assuming that the cash options under the Choices program increases at 6% per year in direct proportion with increases in salary. To the extent that this amount increases at a different rate, the unfunded liability can increase.

Before offering possible solutions to the issues raised above, it is important to discuss the realistic potential for implementation of solutions.

Potential for Change

The multi-plan structure of the County Retirement System has evolved as a product of the pension rights of public employees in California. Any retirement plan design changes intended to reduce costs can be made mandatory for new employees only. Current employees have a vested right in their prospective retirement plan benefits. These vested rights significantly limit a California public employer from implementing retirement plan changes which produce reductions in short term costs. Reductions in costs which result from reductions in benefits for new employees are realized slowly over many years.

As part of our analysis we have read the legal opinion obtained by the Commission. We have taken particular note of the section regarding vesting/contractual rights. It appears clear from the conclusions of this opinion that California's vesting doctrine may very well protect current employees' reasonable expectations to have flexible benefits and transportation allowances considered as part of pensionable compensation during the terms of their employment. This is corroborated by the opinion of the Retirement System's legal counsel. Based upon this opinion, the Retirement Board has formally voted to include transportation allowance and flexible benefits up to the level that could be taken in cash. Thus, any ability to modify the definition of pensionable compensation with respect to these two items under current law may be limited to new employees. This means that any cost reductions which might be realized will occur over an extended period of many years.

Recommendations

The recommendations which follow have important legal, labor relations and policy implications which must be carefully considered before they are implemented. They have not been given any legal review. They have been formulated under the assumption that reductions in retirement plan expenditures are an important fiscal objective. Adoption of these recommendations must be considered in terms of their impact on the entire compensation and benefits package of County employees.

1. Flexible Benefit Cash Options

   In our opinion, granting higher pension benefits when flexible benefit plan cash options are available does not spend employer benefit dollars in the most effective manner. Pension increases so provided are not necessarily essential from a retirement benefit design prospective, but are being brought about as a side-effect of flexible benefit plan design and legal interpretation. Thus, it may well be the case that county dollars spent to support these pension increases would be better spent in other benefit areas or to make different improvements in the retirement area. For this reason, we suggest that future increases in the cash options under the Choices and Options plans be carefully considered, controlled, or possibly eliminated, unless compelling arguments in other areas argue for their increase. In addition, we suggest that the cash option under the MegaFlex and Flex Plans be reduced by one or both of the courses set out below to the lowest level consistent with acceptable flexible benefits plan design and prior commitments to employees.

a. Freeze the MegaFlex plan cash option at its present dollar level for each employee. Any increase in the County contributions to these plans would be provided in the form of benefits rather than cash options.

b. Offset future cost-of-living pay increases granted to employees in the MegaFlex Plan against the MegaFlex cash option. The rationale for using the offset is to avoid reducing the present take home pay available to employees.

   For example, assume an employee is entitled to a County contribution to MegaFlex equal to 17% of salary, all of which is available to be taken in cash. For illustrative purposes, assume that a 3% cost of living raise is given on July 1, 1992. The January 1, 1993 MegaFlex cash option would be reduced to 14%, the 17% option reduced by the 3% pay increase. There would still be a 17% of salary MegaFlex contribution, but there would be less available to take in cash. This strategy could be used to bring the MegaFlex cash options with the Options and Choices plans closer over time. We understand that only 15% of employees are taking all of their MegaFlex contribution in cash.

   To lessen the impact of the reduction of the cash option on employees, the expansion of MegaFlex and Flex to include 401(k) could be investigated.

2. The County should explore the feasibility of offsetting County retiree health insurance contributions by the retirement benefit increases resulting from the inclusion of the flexible benefit amounts into pensionable earnings.

   In Section 3.2 we addressed the policy issue of what the appropriate pay base should be to measure income replacement for retirement benefit purposes. We believe that the mere existence of a flexible benefits plan does not create the need for additional retirement income. The County contributions to the flexible benefit plans resulted from a conversion of employee benefits into cash equivalents. Once these benefit values are incorporated into the pension formula, the retirement program begins replacing both income *and* benefits. As a result, there may be justification to use the increase in benefits that a retiree gets from incorporating flexible benefits amounts into pensionable earnings against the amounts the County would otherwise contribute to that retiree's medical benefits.

As an example, assume an employee retires at age 62 from Retirement Plan D with 30 years of service. Assume further that the employee has final annual earnings of $30,000 before including the MegaFlex annual cash option and $35,100 after including it. The retiree is entitled to a monthly retirement benefit of $1,835.14 of which $266.65 is due to the inclusion of the MegaFlex cash option. This employee would be required to contribute towards the cost of retiree health insurance up to the lesser of the cost of the chosen coverage or $266.65 per month. In future years, the $266.65 would be increased with cost-of-living adjustments.

In effect this extends the flexible benefits concept into the retirement years (albeit without the tax advantages) since the retiree can choose to contribute towards and participate in the County health plan, or to keep the $266.65 per month.

3. Eliminate the incorporation of flexible benefits amounts and transportation allowances from pensionable earnings for new hires. To lessen the impact of the reduction of the cash option on employees, the expansion of MegaFlex and Flex to include 401(k) could be investigated.
4. Either include all future special salary deferral arrangements in pensionable earnings on an as-earned basis or discontinue such salary deferral arrangements. This practice promotes "spiking" of pension benefits which produces inequitable benefits and understatement of ultimate pension costs.
5. The evaluation of executive compensation and benefits issues as they relate to public and private sector employees is beyond the scope of our study. The Commission may want to recommend that this issue be studied further.

APPENDIX

SECTION 3.1
INTRA-COUNTY COMPARISON: EQUITY ELEMENT

TYPICAL EMPLOYEE — SALARY SCALE (INCLUDES INFLATION AND PROMOTIONAL INCREASES PER YEAR)

Job Title	Ages 57 - 61 (Last 5 years of employment)	Ages 32 - 56 (First 25 year of employment)
Secretary I	6.0%	6.0%
Property Agent II	6.0%	6.0%
Senior Secretary III	6.0%	6.0%
DP Manager I	6.0%	6.7%
DP Manager III	6.0%	7.5%
Auditor Controller	6.0%	9.0%

TYPICAL EMPLOYEE — RETIREMENT SAVINGS

Job Title	LA County Plan D rate at entry age of 32	Social Security	Savings	Total Retirement Savings
Secretary I	7.31%	0.00%	1.60%	8.91%
Property Agent II	7.31%	0.00%	1.60%	8.91%
Sr Secretary III	7.31%	0.00%	2.89%	10.20%
DP Manager I	7.31%	0.00%	3.89%	11.20%
DP Manager III	7.31%	0.00%	3.89%	11.20%
Auditor Controller	7.31%	0.00%	3.89%	11.20%

The savings rate used for Secretary I and Property Agent II, were based on a savings rate among participants in the Los Angeles County's 457 Plan. We have also assumed that the retirement savings rate would be made via the 457 Plan.

The savings rate for the Senior Secretary III was based on a national survey that showed an average 401(k) contribution rate among non highly compensated employees in the private sector of 4% per year and a Social Security employee deduction of 6.20% of wages below the Social Security wagebase for a total of 10.20%. Since Los Angeles County has terminated Social Security coverage, we have assumed the total rate of 10.20% would be saved by the Senior Secretary III. Since a Plan D member with an entry age of 32 would pay 7.31% for both normal and cost of living member contributions, this would leave a net available savings rate of 2.89%. We used a similar assumption for the highly compensated employees, DP Managers I and III, and Auditor Controller, but with an average 401(k) contribution rate in the private sector of 5% per year. For all non represented employees we have assumed that the additional retirement savings would be made via the 401(k) plan.

The appropriate employer matches on these contributions were also included.

Section 3.2 General Analysis: Adequacy Element

Illustrations 3.2.1 and 3.2.2

Assumptions:

- Preretirement Income Taxes

  Based on 1991 Internal Revenue Service and California Franchise Tax Board tax rates for single taxpayer with standard deductions.

- Retirement Savings

  Assumed Plan E members will contribute into the County retirement savings plan. Any excess retirement savings (i.e. above federal regulated maximum levels) was assumed to be contributed into some other personal savings program on an after tax basis.

- Postretirement Income Taxes

  Based on 1991 Internal Revenue Service and California Franchise Tax Board tax rates for single taxpayer with standard deductions. We have excluded additional deductions or credits which may be used since our typical employees are assumed to retire at age 62.

ILLUSTRATION 3.2.3

Assumptions:

- Postretirement Income Taxes

  Based on 1991 Internal Revenue Service and California Franchise Tax Board tax rates for single taxpayer with standard deductions. We have included an additional deduction for our typical employees at age 65 and over to reflect additional exemptions at those ages.

SECTION 3.4
COMPETITIVE ELEMENT

THE SURVEY PARTICIPANTS:

PUBLIC EMPLOYERS LISTED IN THE ORDER OF NUMBER OF ACTIVE PARTICIPANTS
State of California
City and County of San Francisco
City of Los Angeles
Orange County
San Diego County
Santa Clara County
City of Los Angeles Department of Water and Power
Riverside County
Alameda County
Sacramento County

PUBLIC UTILITIES
Pacific Telesis Group
Southern California Gas

INDUSTRIAL COMPANIES HEADQUARTERED IN LOS ANGELES COUNTY
Occidental Petroleum Corporation
Atlantic Richfield Company
Rockwell International Corporation
Litton Industries Incorporated
Avery Dennison Corporation

ILLUSTRATIONS 3.4.6 AND 3.4.7

For contributory pension plans, we used the total retirement savings rate described in Section 3.1 Appendix notes and deducted the appropriate member contribution rate. The retirement savings rate was reduced for Social Security taxes, if applicable, and the net rate was used to determine the savings rate for the typical employees in the other employer plans.

For example, Secretary I has a total maximum savings rate of 8.91%. If employer X, is covered by Social Security then 6.20% is deducted for a net of 2.71% (8.91% - 6.20%) of Secretary I's compensation which can be deferred into employer X's 401(k) plan. If employer X matches the employee's contribution at 100% up to 2% of the employee's compensation, then the total contribution into the 401(k) plan under employer X would be 4.71% (2.71% from the employee and 2% from the employer).

If an employee earned over the Social Security wagebase, the amounts above the Social Security wagebase were assumed to be made into retirement savings.

NUMERICAL RELATIVE VALUES USED TO GENERATE ILLUSTRATIONS 3.4.6 AND 3.4.7

Relative Value						
Employer	Secretary I	Property Agent II	Sr Secretary III	DP Manager I	DP Manager III	Auditor Controller
LA Plan D	1.00	1.00	1.00	1.00	1.00	1.00
LA Plan E	0.97	1.00	1.02	1.03	0.91	0.86
Public - 1	1.11	1.10	1.01	0.86	0.87	0.88
Public - 2	0.90	0.96	0.85	0.83	0.82	0.83
Public - 3	1.11	1.11	1.01	0.88	0.86	0.84
Public - 4	1.06	1.05	0.97	0.81	0.84	0.85
Public - 5	1.06	1.04	0.96	0.84	0.78	0.73
Public - 6	1.43	1.45	1.29	1.14	1.10	1.07
Public - 7	1.37	1.39	1.24	1.09	1.05	1.07
Public - 8	1.09	1.15	1.00	0.96	0.94	0.94
Public - 9	1.07	1.12	0.98	0.94	0.92	0.92
Public - 10	0.89	0.86	0.82	0.66	0.69	0.69
Utility - 1	1.12	1.14	1.10	1.01	0.93	0.89
Utility - 2	1.07	1.04	1.00	0.91	0.84	0.80
Corp - 1	1.22	1.22	1.20	1.14	1.04	0.99
Corp - 2	0.99	0.96	0.93	0.87	0.77	0.71
Corp - 3	0.78	0.73	0.74	0.67	0.67	0.66
Corp - 4	1.06	1.02	1.02	1.02	0.87	0.79
Corp - 5	1.03	0.90	0.91	0.94	0.87	0.86