VENTURA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

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August 20, 2007

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VENTURA COUNTY
GRAND JURY

Ventura County Grand Jury
800 S. Victoria Avenue, L#3751
Ventura, CA 93009

Re: **GRAND JURY REPORT TITLED "VENTURA COUNTY EMPLOYEES' RETIREMENT PLAN"**

Members of the Grand Jury:

Attached is the Ventura County Employees' Retirement Association's (VCERA's) response to the Ventura County 2006-2007 Grand Jury's report titled "Ventura County Employees' Retirement Plan".

The response states, as required by Penal Code section 933(c), whether VCERA concurs, concurs in part, or disagrees with the Grand Jury's findings and also includes the required responses to the Grand Jury's recommendations R-01, R-06 and R-07. A signed copy of VCERA's minutes from the August 20, 2007 business meeting at which the Board of Retirement approved the response is included per the Grand Jury's request.

On behalf of VCERA's Board of Retirement, we thank the 2006-2007 Ventura County Grand Jury for its interest in VCERA's operations and the opportunity to respond to its report.

Sincerely,

TRACY TOWNER
Chairman

TIM THONIS
Administrator

Attachments

c. Honorable Colleen Toy White, Presiding Judge

VCERA RESPONSES TO THE GRAND JURY

Findings:

F-01: Concur

F-02: Concur

F-03: Concur

It would be more accurate to state that this is the current, but not the required, composition of VCERA's board. Government Code Section 31520.1 allows four public members, one of whom may be a member of the Board of Supervisors. Traditionally, the Board of Supervisors has chosen to include one of their own members when making the four allowed appointments.

F-04: Concur in Part

Candidates for election to the Board of Retirement are allowed to include with the ballot materials sent to all members a statement of their qualifications. That may explain why most, if not all, who have been so elected have brought a good financial perspective to their board service. VCERA's current elected employee trustees have extensive professional and educational experience in accounting, finance and pension benefit issues. Elected employee members include the County of Ventura's Chief Investment Officer, human resource professionals with extensive backgrounds overseeing a variety of benefit programs including the County of Ventura's deferred compensation plans, and the retired Director of Public Works. Collectively, the group holds graduate and college degrees in business administration, engineering, finance and public administration.

Additionally, VCERA's elected employee trustees actively participate in the many educational forums that are available in the pension industry. For example, the elected employee trustees participate in educational programs offered by the State Association of County Retirement Systems (SACRS), California Association of Public Retirement Systems (CALAPRS), Institutional Investor and the National Council of Public Employee Retirement Systems (NCPERS). This combination of extensive professional experience and continuing education allow the elected employee trustees to make informed decisions in their service as fiduciaries to VCERA.

F-05: Concur

Experienced trustees are an invaluable resource to their fellow trustees and staff.

F-06: Concur

F-07: Concur in Part

Board of Retirement has plenary authority over VCERA's operation as detailed in Proposition 162. It is not accurate to state that the Board makes decisions about interest rates. It would be more accurate to use the term "assumed investment earnings" rather than "interest rates" in describing decisions or assumptions made by VCERA's Board of Retirement. Assumptions regarding interest rates are left to central bankers and fixed income managers.

F-08: Concur

F-09: Concur

F-10: Concur

The finding would be more accurate if it were noted that reciprocity is not a factor in terms of years of employment, but rather carries a potential impact on cost in terms of final compensation. Also, it is important to note that in accordance with Government Code Section 31830, the financial obligations between public retirement systems sharing reciprocal arrangements is delineated in such a manner that no system shall be liable for more than its just financial obligation.

F-11: Concur

F-12: Concur

F-13: Disagree

The Board of Retirement conducts an actuarial valuation annually and provides the valuation results to the Board of Supervisors. Although the Retirement Law of 1937 requires such valuations every three years, VCERA has elected to provide updates to the Board of Supervisors on the Plan's financial condition more frequently.

F-14: Concur in Part

The Board of Supervisors is responsible for making the annual required contributions and determining the level of employee covered payroll to which the contribution rate applies. VCERA's Board of Retirement is responsible for recommending the contribution rates that are the basis for the annual required contributions (Government Code Section 31453).

F-15: Disagree

The elected County Auditor-Controller performed the audit until 1998 at which time Government Code Section 31593 was amended to require the Board of Retirement to conduct an audit of the retirement system. The amendment provided the Board of Retirement the option of utilizing a certified public account or the county auditor. One should note that Government Code Section 31593 does provide that the county auditor may audit the accounts of the retirement system at the request of the board of supervisors.

F-16: Concur in Part

The point at which one can be reasonably expected to become concerned about the funding status of the plan is highly subjective. It would most likely differ between the plan sponsor and the plan administrator. While both have significant interest in the financial health of the retirement system, one could be expected to have greater concerns about present cost, while the other could be expected to have a greater focus on ensuring that promised benefits are paid. Moreover, the funding status of a plan is not the sole measure of a retirement system's financial health. Other measures of "actuarial soundness" would include the financial stability of the plan sponsor and whether a retirement plan has a reliable source of contributions.

F-17: It is not appropriate for VCERA's Board of Retirement to comment on the County of Ventura's labor negotiation process.

F-18: Concur

One could simply say that a plan's funding status declines when growth in plan liabilities outpaces the growth in plan assets. All scenarios detailed in the Grand Jury's report fit this description. One could also include benefit enhancements in these scenarios.

F-19: Concur in Part

A six year period is a very short time frame for analyzing a pension plan's funded ratio and is of limited value in ascertaining a fund's long-term financial health. By extending this analysis over a 12-year period (1995-2006), VCERA's funding status would average 103.5%. In making investment and economic assumptions, time horizons varying from 15 to 30 years are commonly used by public pension fund investment consultants and actuaries.

F-20: Concur in Part

As stated in F-19, it is more meaningful to view a longer period of time in analyzing the impacts of actuarial gains and losses. For example, if one reviewed the six-year period from June 30, 1995 through June 30, 2000, there would be actuarial gains of $63.1 million due to actual salary increases that were smaller than expected and $464 million due to actual investment earnings that were greater than expected.

F-21: Concur in Part

The benefits described were the result of Board of Retirement actions pursuant to Government Code Sections 31592 and 31592.2. Supplemental benefits may be granted pursuant to these code sections when the fund has sufficient excess earnings in any given year(s), regardless of the funded status of the Plan.

F-22: Concur

Scenario describes the typical attributes of a maturing defined benefit plan

F-23: Concur

The Board of Retirement believes it important to note that over the same three year time period the total fund return of 11.6% was significantly higher than the assumed return of 8%. In addition, the fixed income portion VCERA's portfolio outperformed its respective benchmark during this period.

F-24: Concur

F-25: Disagree

Investment management fees increased primarily due to the increase in the size of VCERA's investment portfolio. The addition of new two real estate managers increased the fees marginally.

Investment management fees are charged as a percentage of total assets under management. Over the last three years, VCERA's assets under management have increased from $2.2 billion in 2004 to $2.6 billion in 2006. This $400 million increase in assets accounts for approximately $1 million of the cited increase. The remainder of the increase is attributable to the addition of a new fixed income manager, new global equity managers and real estate managers.

The Board of Retirement believes the Grand Jury would benefit greatly by comparing VCERA's investment fees to comparable pension plans rather than evaluating fees solely by noting an increase over a three year period. VCERA participates in many peer comparisons and the results illustrate how investment costs are contained by VCERA.

For example, in the most recently published Cost Effective Management (CEM) Study, VCERA's investment costs were approximately 75% of those of comparable plans. The study showed that VCERA's costs were 30/100 of 1% of assets under management, while the cost of operating comparable plans was 42/100 of 1% of assets under management. The bottom line is that VCERA operates with a cost savings of approximately $3 million in comparison with similar plans.

F-26: Concur

F-27: Disagree

While it is theoretically possible that political considerations might at times influence a particular board member's vote, in practice that does not appear to have happened. The board members have extensive training in the fiduciary duties that are required of them when making all decisions affecting the plan. In particular, the board has been educated on the importance of making decisions that are in the best interests of VCERA and its members, rather than the interests of a specific constituency. A review of the minutes of the board meetings will show that the members take their fiduciary duties seriously when considering all items, including decisions that concern actuarial assumptions.

F-28: Disagree

The implementation of VCERA's contribution rates is accomplished timely and in accordance with Government Code Sections 31453 and 31454. According to these sections of the law, the Board of Retirement shall, at least 45 days prior to the beginning of the succeeding fiscal year, recommend changes to the Board of Supervisors in the contribution rates. The Board of Supervisors shall, no later than 90 days after the beginning of the fiscal year, adjust the contribution rates in accordance with the recommendation from the Board of Retirement. The following events that have occurred in fiscal year 2006/07 are illustrative of this process:

- The Board of Retirement adopted, on January 22, 2007, new contribution rates recommended by its actuary and based upon the June 30, 2006 valuation.
- Board of Supervisors adopted, on March 27, 2007, recommended contribution rates after public presentation by VCERA.
- New employer and employee rates to be implemented on September 24, 2007 as detailed in the County of Ventura's budget process.

F-29: Concur in Part

The employee contribution rate illustrated for non-safety employees is for Tier II General Members. The employee contribution rate for Tier 1 General Members is currently 8.89%, including COLA. Certain non-safety Tier II General Members pay an additional 2.63% in COLA contributions.

F-30: Concur

F-31: Concur

F-32: Concur

F-33: Concur

F-34: Concur

The Board of Retirement believes it important to note that the contribution rates in effect during this period were recommended by VCERA's actuary and were based upon the annual actuarial valuations performed for those impacted years. VCERA's funding methodology for this period of time was the subject of legal challenge which resulted in judgment in VCERA's favor. The Court ruled, among other things, that VCERA's funding methodology was lawful.

F-35: Concur

F-36: It is not appropriate for VCERA's Board of Retirement to comment on the finding.

F-37: Concur

The process described is in accordance with Government Code Section 31453.

F-38: Disagree

The Board of Retirement's role is to administer the County of Ventura' defined benefit plan in accordance with the Retirement Law of 1937 and its administrative function does not include passing judgment of Board of Supervisor decisions regarding compensation and other decisions impacting the County of Ventura's workforce.

F-39: Concur

The Board of Retirement's decision was done in accordance with a recommendation from its actuary and had the effect of making VCERA's future benefit payments and funding status less reliant on future investment income.

F-40: Concur

F-41: Concur

F-42: Concur in Part

The Board of Retirement's decision to change the basis for the amortization of a plan surplus or deficit in August 2004 involved several factors. First, the Board of Retirement needed to decide whether a "rolling" amortization period or a "fixed" amortization period was best for VCERA. Second, the Board of Retirement needed to weigh the benefits of the shorter ten-year amortization period in terms of lower overall costs against the increase in the volatility of employer contributions inherent in ten-year amortization periods. Finally, the Board of Retirement needed to establish an appropriate amortization period if it was decided that the existing ten-year "rolling" period was not the best choice for VCERA.

By definition, a "rolling" amortization period is one that remains the same each year, or does not decline. The effect of utilizing a "rolling" amortization period is that the amortization payment made in a given year is primarily an interest payment and has little impact on a plan's Unfunded Actuarial Accrued Liability (UAAL). For example, at June 30, 2003, VCERA's UAAL was $144 million. If the 10-year rolling amortization had remained in place for **15** years, through June 30, 2018, there would be a projected UAAL remaining of some $71 million of the original $144 million. The Board of Retirement believed that VCERA's UAAL needed to be fully amortized within a reasonable period and used the above analysis as a basis to change VCERA's amortization period from a "rolling" amortization period to "fixed" amortization periods.

Another drawback of a "rolling" ten-year amortization period is the volatility that such a relatively short period may cause in terms of employer contribution rates. This phenomenon is best illustrated by VCERA's amortization of the large actuarial gains, earned primarily due to plan investment performance, in the late 1990's. The amortization of these large gains, over "rolling" 10-year periods, generated large actuarial "credits" to VCERA's normal plan costs resulting in the County of Ventura not being required to make an employer contribution for four years. Employer contribution rates would not have been impacted as materially if a longer amortization period were in place during this period of greater than anticipated investment gains. The same analysis would apply to large actuarial losses except that the shorter amortization period would cause a larger increase in employer contribution rates when compared to utilizing a longer amortization period.

After considering all of the above factors, and with recommendations from its actuary and input from the County of Ventura, the Board of Retirement decided it would be in VCERA's and the County of Ventura's best interest to have separate 15-year fixed amortization periods effective with the results of each actuarial valuation. VCERA believes that in the long run, plan costs may actually be lower utilizing longer fixed periods rather than the previous 10-year "rolling" periods because the UAAL from a given plan year will be paid earlier under a 15-year fixed schedule than under a 10-year "rolling" amortization schedule. Additionally, one can expect less volatility in employer contribution rates under the 15-year fixed amortization periods.

F-43: Concur in Part

The written analysis considered by the VCERA's Board of Retirement recommended an 8% earnings assumption rate and only during discussions on the subject did the actuary recommend the range of 7.75% to 8.00%. The financial impact of adopting a 7.75% earnings assumption rate would have been approximately 2% of covered employer payroll. This translated into an approximate $100 million increase in liabilities at the time the Board of Retirement considered the matter. This is $78 million less than the amount illustrated in F-41.

F-44: Concur

F-45: Concur

VCERA's Board of Retirement believes it important to note that such recognition of the gains will, all things being equal, result in lower future employer contribution rates.

F-46: Concur

F-47: Concur

F-48: Concur in Part

VCERA believes that this transaction is not a pure exchange, but rather is the refinancing of one debt for another with a resulting lower interest payment.

F-49: Concur

F-50: It is not appropriate for VCERA's Board of Retirement to comment on the County of Ventura's POB costs.

F-51: It is not appropriate for VCERA's Board of Retirement to comment on the County of Ventura's financing options.

Conclusions:

C-01: Disagree

The Board of Retirement has provided details on VCERA's plan annually as part of the contribution rate setting process detailed in Government Code Sections 31453 and 31454. Please see response to F-28.

C-02: Concur in Part

VCERA's funding status has fallen as illustrated by the conclusion; however, the Board of Retirement believes it important to analyze the actuarial process over longer periods of time in order to gain a full perspective. For example, if one reviewed these same factors over the last 12 years one would note many of the investment and salary losses cited in the conclusion would be offset by gains in the prior six-year period from 1995-2000.

C-03: It is not appropriate for VCERA's Board of Retirement to comment on County of Ventura policy.

C-04: Disagree

The Board of Retirement has been both proactive and timely in making changes to VCERA's actuarial assumptions. For example, over the last several years changes in VCERA's investment earnings assumption, mortality assumption and disability assumptions have been accomplished. All changes were the result of careful study by the Board of Retirement following the completion of VCERA's triennial actuarial investigations. These investigations analyze the differences between VCERA's actuarial experiences and actuarial assumptions over three year periods.

The "normal" process is for VCERA's actuary to identify, during the actuarial investigation, the material differences between plan assumptions and actuarial experiences. The Board of Retirement and its actuary then track these "experience" differences through a second 3-year investigation cycle in order to determine whether the differences noted are temporary or exhibit consistency. If it is believed that the differences identified will remain consistent, then the Board of Retirement's actuary will recommend a change in assumptions for adoption by the Board of Retirement. Plan contribution rates would be negatively impacted if the Board of Retirement changed its assumptions each and every year that there were noted differences between actuarial experiences and assumptions,

The Board of Retirement believes it important for the Grand Jury to know that VCERA's processes regarding actuarial decisions impacting plan contribution rates have been challenged in the Courts. In a recent case, *Mathews v. Ventura County Employee Retirement Association and County of Ventura*, Superior Court Judge Frederick H. Bysshe found that "VCERA's decisions in allowing the County to make reduced or no contributions during the relevant time period was not the result of arbitrary and capricious decisions which lacked evidentiary support." The Court affirmed that VCERA's Board of Retirement will make changes to actuarial assumptions only after determining that the evidence supports the basis for a change in actuarial assumptions.

VCERA's Board of Retirement will continue to follow the processes currently in place in order to make timely and appropriate decisions regarding VCERA's actuarial assumptions.

C-05: Concur in Part

VCERA's Board of Retirement concur that investment fees have increased over the last three years and as explained in F-25, most of the increase is attributable to the appreciation in VCERA's plan assets since June 30, 2004. The Board of Retirement believes it important for the Grand Jury to note that VCERA's annualized investment return for the 3-year period ending June 30, 2006 was 11.6%. The annualized return for the period was greater than the actuarial expected return of 8%.

C-06: It is not appropriate for VCERA's Board of Retirement to comment on the County of Ventura's future budgets.

C-07: Disagree

The implementation of VCERA's contribution rates are accomplished timely and in accordance with the law as discussed under F-28.

C-08: Concur in Part

VCERA's Board of Retirement believes that the positive factors of defined benefit plans outweigh the negative factors. Defined benefit plans provide an income replacement feature that is not present in defined contribution plans and offer this feature with better investment returns and with lower investment costs than defined contribution plans. If actual experience differs from expectations in a defined contribution plan, the risks of individual employees not saving enough may ultimately fall back on local governments in terms of additional social programs.

C-09: Concur in Part

As stated in F-20, VCERA's Board of Retirement believes it important to review actuarial assumptions over longer periods. One would note actuarial gains due to salary increases being less than expected of $63.1 million if the Grand Jury extended its analysis to include the period June 30, 1995 through June 30, 2000.

C-10: Concur in Part

The issuance of POBs may result in lower overall costs to taxpayers assuming the POBs are issued at a lower interest rate than the Board of Retirement's actuarial assumed earnings rate.

Required Responses:

R-01:

Except as noted below, it has always been VCERA's practice to provide all recommended information to the Board of Supervisors and/or County Executive Office by way of the annual actuarial report, triennial actuarial investigation, Comprehensive Annual Financial Report (CAFR), and written communications. Current assumptions relating to compensation increases, investment earnings and plan demographics will continue to be important features of the actuarial report. Details of variances between actuarial assumptions and actual experiences, along with any recommended changes based on such variances, are illustrated in the annual actuarial valuation report and in the triennial experience investigation report.

The long-term forecast of VCERA's funded status remains at 100% with the knowledge that there will be a degree of variability around the long-term target. Yearly forecasts of the plan's funded status would be at best an educated guess and have minimal impact on the decision making process. Fees paid to investment advisors, and the impact of such fees on VCERA's plan performance, will continue to be reported in VCERA's Comprehensive Annual Financial Report and in each business meeting agenda. VCERA's business meeting agendas also include reports on monthly and year-to-date investment performance, net of fees. Prior to each monthly business meeting, VCERA provides to the County of Ventura a copy of the agenda.

In terms of actuarial assumptions that are recommended by VCERA's actuary but not adopted by the Board of Retirement, VCERA will in the future provide written explanation as to why the recommendations were not adopted.

Implementation Date: VCERA will provide notice of any exceptions to recommended actuarial assumptions following each occurrence.

R-06:

Based upon a thorough investigation, as detailed in the response to F-42, the Board of Retirement does not believe that it is in VCERA's best interest to return to a 10-year rolling amortization schedule. Such a move would reintroduce greater volatility into the employer contribution rate setting process and potentially lead to an intergenerational transfer among taxpayers of the current Unfunded Actuarial Accrued Liability (UAAL). The Board of Retirement and its consulting actuary contend that fixed 15-year amortization periods are the most appropriate for VCERA and the County of Ventura.

Implementation Date: Will not be Implemented.

R-07:

VCERA will continue to follow the law and the existing process, as described in our response to F-28, in recommending new employer contribution rates on a timely basis to the Board of Supervisors.

Implementation Date: Will not be Implemented.