



## GENERAL SUBSIDY

### Frequently Asked Questions (FAQ)

#### 1. How was the General Subsidy created?

Starting in the 1970s, pursuant to Government Code section 31691, the SBCERA Board of Retirement amended its By-laws authorizing the use of excess earnings to pay a portion of a retired member's health insurance premiums if the retired member had previously enrolled in the health care insurance plans offered by San Bernardino County. This was called the *Health Care Subsidy*. The money for this subsidy came from excess earnings as authorized by Government Code sections 31691, 31592, and 31592.2. Each year thereafter, the Board of Retirement would pass a resolution determining the amount of Health Care Subsidy SBCERA would pay from excess earnings. Note only retired members with County health care insurance received this subsidy. Retired members who lived out-of-state or had no access to the County health care insurance did not receive the Health Care Subsidy.

The Health Care Subsidy generally increased over time. However, no subsidy was paid in 1994-1995. Since then the Board of Retirement has never resumed the Health Care Subsidy.

In 1996 the Board of Retirement began paying a non-vested discretionary subsidy, pursuant to Government Code section 31691.1, called the *General Subsidy*. This is a taxable allowance paid to all retired members based upon years of service. The General Subsidy, unlike its predecessor, is not dependent upon a retired member enrolling in the County health care insurance program.

#### 2. How much is the General Subsidy?

Currently, the General Subsidy ranges from a minimum of \$115 per month for 10 years of SBCERA service credit up to a maximum of \$230 per month for 20 or more years of SBCERA service credit. See SBCERA's Benefits Policy 003 - Discretionary Retiree Subsidy.

#### 3. Is the General Subsidy a vested benefit?

No. The Board of Retirement does not have statutory authority to grant a vested benefit. Pursuant to Government Code sections 31592, 31592.2, 31691, 31691.1, and 31691.2, the General Subsidy is not a vested benefit and no member or retired member has a vested right to receive the General Subsidy.

**4. Why doesn't the Board of Retirement vest this General Subsidy or some other kind of additional benefit for retirees?**

Again, there is no statutory authority for the Board of Retirement to vest any subsidy or benefit. Only the County Board of Supervisors can adopt and vest an additional benefit for retired members. The reason for this is any additional *vested benefits* must be actuarially funded in part by employer and active-employee contributions and not by current retirees.

**5. Would the investment earnings on my contributions as an active member pay for part of the General Subsidy?**

No. SBCERA is a *defined benefit* plan not a *defined contribution* plan. Upon retirement, retirees no longer have a right to the assets of the trust fund. Instead, retirees have a vested, contractual right to be paid a monthly retirement benefit for the rest of their lives with a continuance, if applicable, to their beneficiaries. Even if they did have a right to the assets of the pension fund, within approximately seven years of retirement, 100% of a retiree's employee contributions plus interest would have been paid out to them in the form of a monthly benefit.

**6. How is the General Subsidy funded?**

The statutory authority for the Board of Retirement to pay the cost of discretionary benefits, such as the General Subsidy, comes from Government Code sections 31592 and 31592.2.

31592. Earnings of the retirement fund during any year in excess of the total interest credited to contributions and reserves during such year shall remain in the fund as a reserve against deficiencies in interest earnings in other years, losses on investments and other contingencies, except as provided in Sections 31529.5 and 31592.2.

31592.2. In any county, earnings of the retirement fund during any year in excess of the total interest credited to contributions and reserves during such year shall remain in the fund as a reserve against deficiencies in interest earnings in other years, losses on investments, and other contingencies, except that, when such surplus exceeds 1 percent of the total assets of the retirement system, the board may transfer all, or any part, of such surplus in excess of 1 percent of the said total assets into county advance reserves for the sole purpose of payment of the cost of the benefits described in this chapter.

Where the board of supervisors has provided for the payment of all, or a portion, of the premiums, dues, or other charges for health benefits, Medicare, or the payment of accrued sick leave at retirement to or for all, or a portion, of officers, employees, and retired employees and their dependents, from the county general fund or other sources, the board of retirement may authorize the payment of all, or a portion, of

payments of the benefits described in this paragraph from the county advance reserves.

## 7. What are excess earnings?

The subject of excess earnings is hotly debated and commonly misunderstood. Excess earnings are determined on a year-by-year basis according to Government Code sections 31592 and 31592.2. When these statutes were first enacted, the pension fund was limited by law to investing only in bonds. In those days the rates of return on bonds were very stable and it was rare for any Board of Retirement to exceed its actuarially-assumed rate of return on investments. Under these Government Code sections a pension fund could have excess earnings in a particular year and yet not be fully funded. Indeed during those early years

SBCERA and all the other government pension funds were considerably underfunded.

A momentous change occurred in 1984 when the State Legislature allowed public pension funds to invest in any form or type of prudent investment. Since then the rate of return on investments has varied greatly from year-to-year depending on the financial markets. On a positive note, beginning in 1984 the funding rate of pension funds started to increase to a point that SBCERA was 116.1% funded in 1998. During the 1990s, SBCERA was also able to set aside several million dollars to fund the discretionary General Subsidy. In 2003 the County granted additional vested benefits to active safety members. Since then largely due to the Great Recession, SBCERA’s funding is down to 85.5%.

Unfortunately, Government Code sections 31592 and 31592.2 did not change in 1984. No one questioned whether the method of determining excess earnings based upon coupon bonds was still valid in the age of investing in stocks, real estate, and other investment assets. But the issue came to a head during the financial crisis in the City of San Diego. A challenge was presented to all California public pension plans in the *Report of the Audit Committee of the City of San Diego* (commonly referred to as the *Kroll Report*), dated August 8, 2006, by a distinguished consulting firm. The *Kroll Report* is 266 pages long. You may obtain a copy of the *Kroll Report* from the City of San Diego or the San Diego Tribune website.

The *Kroll Report* raised the issue as to whether an actuarially-based, public pension fund, like SBCERA, could properly use surplus or excess earnings to fund non-vested, non-actuarial based benefits, such as SBCERA's General Subsidy. What the *Kroll Report* said in essence is Government Code sections like 31592 and 31592.2 may allow the Board of Retirement to use excess earnings to fund the General Subsidy, but if the Board of Retirement is funding non-actuarially funded, non-vested benefits (General Subsidy) at the expense of the actuarially-funded, vested benefits (pension benefits), then the Board members will have violated their fiduciary duty as trustees. This is a serious allegation.

On December 19, 2006, SBCERA's fiduciary counsel, Michael Toumanoff, wrote a thorough legal opinion addressing the concerns of the *Kroll Report*. This opinion lays out a very detailed checklist allowing the Board of Retirement to use excess earnings to fund the General Subsidy under certain conditions if appropriate actuarial information has been provided to the Board on the financial impact of the General Subsidy on the contribution rates, the earnings assumption rate, the overall funding of the plan, and other issues.

Based upon all of this information, the Board of Retirement, since 2007, has maintained the discretionary, non-vested General Subsidy at its current levels.

**8. What is the process of interest crediting and how does it relate to excess earnings?**

Pursuant to Government Code section 31592.2, the Board of Retirement must credit interest from investment earnings before declaring excess earnings are available for the General Subsidy.

**9. In the process of interest crediting and determining excess earnings does the Board of Retirement have to credit the General Subsidy reserve if the actual return on investments for the year exceeds the actuarial-assumed rate-of-return?**

No. Government Code section 31592.2 gives the Board authority to credit interest against deficiencies in interest earnings in other years, losses on investments, and other contingencies before declaring excess earnings.

**10. Does the Board of Retirement have a policy on interest crediting?**

Yes. This is SBCERA's Actuary & Audit Policy 002 - Interest Crediting Procedures and Excess Earnings Allocation.

**11. How long will the money set aside for the General Subsidy last?**

If the present levels of the subsidy are maintained, and no additional interest is credited to this reserve, the amount set aside to fund this subsidy will run out in October 2011.

**12. Is it true the County didn't have to pay any employer contributions a few years ago because the Board of Retirement gave the County a rate holiday?**

No. the County has always paid its actuarially-required employer contributions every year; however, the required contributions vary depending on the funded status of the pension system. Initially, the retirement system was set up so the employer and employee each paid half of the actuarial contributions needed to fund future retirement benefits. While the employee contributions are based on age of entry and

do not change significantly, the employer contributions fluctuate depending on the funding status.

When the retirement system is *under-funded*, the County and other employers pay far more in contributions than the employees. When the retirement system is *over-funded*, the County and the other employers pay less in contributions.

The County and South Coast Air Quality Management District gave the pension fund \$413 million additional dollars in fiscal year 1995-1996 and \$506 million additional dollars in fiscal year 2003-2004, raised through pension obligations bonds, to pay down the unfunded actuarial accrued liability. This combined sum of \$919 million dollars paid to the pension fund is many times greater than the reduction in employer contributions the Plan Sponsors received when the plan was over-funded.

**13. Some retired members live on only their County pensions and are truly in need. Can the Board of Retirement restrict the General Subsidy to needy members only?**

No. Upon advice of fiduciary counsel, the Board is unable to determine individual need based upon the size of a person's retirement benefit.

**14. After giving the General Subsidy for so many years, isn't it considered a vested benefit?**

No. The General Subsidy has only been given for 15 years. See the answer to Q1 above. In addition Article VI, section (3) of the SBCERA By-laws clearly states the General Subsidy is a discretionary, non-vested benefit. Further, there is no case law in California for the proposition a non-actuarial, non-vested retirement subsidy given at the discretion of an actuarial-based California public pension system can be vested simply by the passage of time or perceived entitlement.

**15. How does the decision to transfer \$40.6 million from the General Subsidy Reserve to the County Advance Reserve made by the Board of Retirement on April 7, 2011 affect the General Subsidy Reserve and future payments to retirees and beneficiaries?**

On April 7, 2011, the SBCERA Board of Retirement voted to approve the transfer of \$40.6 million from the General Subsidy Reserve to the County Advance Reserve (also known as the Employer Current Service Reserve). The County Advance Reserve is an SBCERA reserve account that holds the total accumulated employer contributions for the benefit of all General and Safety members for service rendered to help fund future benefits. The decision to transfer the funds has the following impacts:

- The General Subsidy Reserve will be depleted, ending the possibility of future subsidy payments.
- All General Subsidy payments will end after October 31, 2011.

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- SBCERA’s funding status will increase slightly.
- Average employer contribution rates will decrease over the next 20 years.

This document is current as of June 1, 2011.

**Disclaimer**

*This FAQ Sheet was drafted by the SBCERA staff in order to help members understand complex pension issues surrounding the General Subsidy. Every effort has been made to ensure the accuracy of the information offered. However, you should not rely solely on the information contained herein. In the event of any discrepancy between the information contained in this FAQ and the Government Code provisions, SBCERA By-laws, Policies, and Minutes referenced above, the Code provisions, By-laws, Policies, and Minutes will govern.*