

KERN COUNTY EMPLOYEE RETIREMENT ASSOCIATION SUMMARY

The Audit and Administration Committee (Committee) of the 2009-2010 Kern County Grand Jury has spent approximately three months reviewing the operations of the Kern County Employees Retirement Association (KCERA). Prior to our review and during the investigation numerous newspaper articles have been written about Governmental Retirement Plans i.e: Public Pension Plans.

The Committee approach has been to try to make an objective unbiased investigation of KCERA to maximize taxpayer dollars spent and to maintain the level of service provided by County Government.

KCERA and Kern County are bound by the provisions of the 1937 Retirement Act of the State of California (ACT) and various court decisions which have been issued interpreting the Act. As pointed out in the report, the model from which the Act was created has changed over the years, but the ACT has not been changed to reflect societal changes. For example, many corporate pension plans which started as Define Benefit Plans (a promise to pay participants specified benefits which are determinable and based on such factors as age, years of service and compensation) have had to change to Define Contribution Plans (provide an individual account for each participant and benefits based on amounts contributed to the account by the employee and employer and investment experience) since the burden of providing benefits until death have become too onerous for corporations to sustain.

Kern County took steps in 2007 to modify retirement benefits and the Board of Supervisors (BOS) is to be commended for taking this action. But it is not enough; the BOS need to set up a panel to determine the impact of new hires and salary increases will have on the County's pension contributions. In addition, the BOS working in conjunction with other counties should work toward modifying the ACT to set up a Define Contribution Plan for new hires.

The BOS need to be informed on a quarterly basis on the performance of the KCERA investments and the potential retirement contributions the County will have to fund.

The KCERA Board and management perform a conscientious job in the execution of their duties. The recommendations presented in this report are designed to improve efficiencies in operation and safeguard the retirement assets.

KERN COUNTY EMPLOYEE RETIREMENT ASSOCIATION INTRODUCTION

The 2009-2010 Kern County Grand Jury Administration and Audit Committee is aware of the wide publicity given to Governmental Pension Plans and the fact KCERA had not been the subject of a Grand Jury report for approximately 13 years. The last review of KCERA was undertaken by the 1997-1998 Kern County Grand Jury. Much has changed since the report was published; the changes are described in the following report.

Considerable attention has been given to various County Retirement Plans with the Committee having closely reviewed the reports published by the Fresno County 2009-2010 Grand Jury, the Ventura County 2006-2007 Grand Jury, the Marin County 2006-2007 Grand Jury and several newspaper articles. A full listing of documents reviewed is attached. Some consistent themes from the Committees readings are:

- Investment portfolios during the past three years of all retirement plans examined have performed considerably below projections;
- Employees receiving life time benefits are retiring younger and living longer;
- County BOS has been overly generous in awarding benefits to County employees;
- Government Employees have been granted salary increases in excess of actuarial assumptions outside the 1937 retirement act model.

It is important to point out existing retirees benefits are established by contract determined at the time of the employee's retirement; are protected by law and cannot be changed. Any changes which are suggested or proposed would apply to newly hired employees only.

The KCERA was established by County Ordinance in 1945 with Kern County being one of the 20 counties in compliance with the ACT. The assets of KCERA have grown from approximately \$1.1 Billion in 1996 to \$2.0B in June of 2009. There were 21 employees in 1996 and 19 in 2010. The retirees receiving benefits in 1996 were 4,622; in 2010 5,919 members were receiving benefits. In addition to the County of Kern 13 Special Districts participate in the KCERA retirement plan.

The Foreman of the 2009-2010 Kern County Grand Jury is a member of the KCERA Board; as a result the Foreman recused himself from the investigation (the Foreman Pro Tem assumed the duties of the Foreman with regard to all meetings and discussions pertaining to KCERA). Separate confidential minutes of special Grand Jury meetings on KCERA were maintained on a secure computer to which the Foreman had no access.

ORGANIZATION:

The Organization of the Board of Retirement (BOR) is specified in the 1937 ACT and is composed of nine members. The County Treasurer is required by law to be a member, a member is elected by the retirees, two members are elected by the general employees, two members are elected by safety employees (one of which is an alternate) and four members are appointed by the Board of Supervisors. The Executive Director is appointed by the KCERA Board and supervises a staff of nineteen employees. The Annual Financial Report is prepared with audited statements certified by an outside accounting firm. There are several documents which govern the operations of KCERA. These documents include By Laws, Investment Goals and a Business Plan.

The By Laws and Regulations of the Board of Retirement specify required meetings, compensation, membership, contributions by members, withdrawal of contributions, normal retirement age and separations, death benefits and investments.

The Investment Plan sets forth the framework for investment policy making and investment objectives within the context of California laws. The document also focuses on the investment responsibilities of the Retirement Board. The pertinent Gov. Code Sec. 31594 and 31595, give the Retirement Board exclusive control of the investments.

The operations of the KCERA are broken into two major functions:

1. Investing retirees' funds to provide future benefits.
2. Payment of benefits to Kern County retirees.

KERN COUNTY EMPLOYEE RETIREMENT ASSOCIATION

PURPOSE OF INQUIRY:

The Administration and Audit Committee of the 2009-2010 Kern County Grand Jury conducted an inquiry and investigation into the function of the Kern Employees Retirement Association (KCERA) pursuant to California Penal Code §925.

BACKGROUND:

KCERA was established in 1945 to provide retirement allowances and other benefits to all permanent general and safety employees of the County of Kern and of participating Special Districts. The Association was established under the provisions of the State of California 1937 County Employees' Retirement Law (ACT). The retirement plan is administered by the Kern County Board of Retirement. The KCERA Board is responsible for establishing policies governing the administration of the retirement plan, determining benefit allowances and managing the investment of the Association's assets.

The staff of KCERA (19 staff members) and the Executive Director assist the Board in the performance of the duties prescribed by the Retirement Law of 1937 and the bylaws, policies and procedures adopted by the KCERA Board.

PROCESS:

The committee attended KCERA board meetings, met with the Executive Director of KCERA, several members of KCERA Board, County Supervisors, the County Administrative Officer (CAO) and County Counsel to discuss the organization and operation of KCERA. In addition, the Committee attempted to gather information about the investments of KCERA and the procedures for selecting Investment Managers. Information pertaining to a basic understanding of retirement benefits determined and paid was secured. The Committee reviewed KCERA Board meeting minutes and several other documents detailed in this reports and in the Sources and References section.

FINDINGS:

1. KCERA now occupies 4,000 sq. ft. of office space rented from the County of Kern and is planning on building a new 14,000 sq. ft. office building in Southwest Bakersfield. The Committee investigation revealed that an analysis of lease vs. purchase was made but a cost benefit study (an analysis to determine if the use of funds was better used to construct a new building or invest the funds and rent) was not undertaken in the decision to construct a new building.

2. KCERA is paying retirement benefits to 5,919 members and supplemental purchasing power protection plan benefits to 982 retirees or their beneficiaries.
3. The salaries of the employees are established by the KCERA Board with the CAO approval. All expenses of KCERA are paid out of investment earnings which are capped at 0.18% of the assets.
4. The Board of KCERA created KCERA Property Inc., to hold the real property (new office building). Three KCERA board members comprise the board of the new entity and are paid \$100 per meeting in addition to the KCERA Board payment of \$100 per meeting up to a combined total of five per month.
5. The number of County employees currently eligible to receive retirement benefits is 7,858 and 3,155 employees are currently contributing (paying) into the Retirement Fund. The remaining 4,703 employee's are having their contributions (payments) made by the county.

Membership	Total Employees	Contributing	Non-Contributing
General Tier I	5178	1699	3479
General Tier II	889	889	
Safety	1791	567	1224

The Courts and Special District employees have not been included in the numbers above.

Tier I employees consist of employees hired prior to October 27, 2007, who are eligible to retire at age 50 with 10 years of service, at any age with 30 years of service or at age 70 regardless of years of service. Retirement benefits of 3% of highest annual earnings at age 60 per year of service will be paid for this group.

Tier II employees consist of those employees hired on or after October 27, 2007 who are eligible to retire at age 50 with 10 years of service, at any age with 30 years of service or at age 70 regardless of years of service. The benefit level for these employees is lower than those for Tier I. Retirement benefits of 1.62% of highest annual earnings at age 60 per year of service will be paid to this group.

Safety employees consist of those employees eligible to retire at age 50 with 10 years of service or regardless of age with 20 years of service. Those employees hired after July 10, 2004 pay a Supplemental contribution rate. Retirement benefits of 3% of highest annual earnings at age 50 per year of service will be paid to this group.

In addition, benefits are adjusted annually by the percentage change in the Consumer Price Index for the preceding calendar year (capped at 2.5%).

Any cost saving can only be achieved by creating a new tier which would apply only to newly hired employees.

6. The County has created a deferred compensation plan to help employees supplement the retirement plan (I.R.C. 457). The County will match up to 6% of a new employee's contribution into the plan. In addition, to promote the plan, the County gives newly hired employees an additional 6%, of their base salary to encourage the employees to participate in the plan. This plan was established on October 2, 1979, and employer match began on October 27, 2007. Presently, there are 3,285 current employees contributing to this plan. There are 888 county employees eligible for the matching plan which 397 are currently contributing. Since October 27, 2007 the County has provided matching funds of \$1,210,001. The total fund is administrated by the Kern County Treasurer-Tax Collector and is a self directed plan whereby the participants select their own investment funds. The fund balance is presently \$303,100,616.
7. During the year ended June 30, 2009, the Fund assets decreased \$686 Million and the fund's total return was -21.7% (which is the net amount after all expenses). The actuarial valuation funded ratio (the percent of fund actually funded) as of June 30, 2008 declined to 72.3% as compared to 77.2% on December 31, 2007. KCERA presently has a pension obligation which is under funded by \$1.2 Billion.
8. The Retirement Association experienced an incident of "identity theft" the past year. This theft was the result of a part time employee having access to sensitive employee information and with knowledge of the Association's computer system was able to divert funds left on deposit with the Association by a terminated employee to separate a bank account.
9. Kern County's contributions to the Retirement fund have grown over the years. The table below shows contributions made over the past six years for Fiscal Years ended June30 (per KCERA's Annual Report June 30, 2009 & 2008):

2004	2005	2006	2007	2008	2009
\$48,759,946	\$60,268,141	\$100,734,230	\$128,134,672	\$137,263,673	\$138,814,789

Projected future contribution by KCERA's Actuary (per letter dated March 24, 2010) are as follows:

2010	2011	2012	2013	2014	2015
\$151,900,00	\$193,300,000	\$207,300,00	\$226,300,000	\$256,900,00	278,100,00

As can be seen from the above table the County's contribution grows each year consuming a larger portion of the County's Budget. In the Fiscal Year ending June 30, 2011 pension contributions approach 10% of the Budget.

COMMENTS:

During our review the Committee noted KCERA spent approximately \$6 million in investment fees. Although these fees appears to be excessive the results described in Fact Number 7 indicate the investment managers returns exceeded those produced by the Standard and Poor's 500 Index.

The KCERA investment return of -21.87% for the period ending June 30, 2009 and -6.50% for the previous year do deviate from the market; KCERA's returns over a longer period of time exceed the market. The KCERA annual report showed positive results in 6 of the last 10 years averaging 12.15% in the good years and -9.89% for the down years. Through smoothing techniques the returns are positive for the 10 years at 6.47%.

The modifications in the 1937 Retirement Act allow the Retirement Investment Committee great latitude in investment decisions. However, the Investment Committee needs to exercise great care in its investment decisions. The Committee is concerned that many of the investment contracts reviewed (not all contracts were reviewed) allow the investment managers the ability to invest in less than investment grade securities up to 30% of the funds under the manager's control. In looking at the total portfolio of KCERA it was noted that 20% of KCERA's securities were invested in less than investment grade quality.

The KCERA budget is defined in the ACT which mandates that operating expenses shall not exceed 0.18% of the assets under management; currently for KCERA (with \$2 Billion in assets as of June 30, 2009), this allows a budget of approximately \$3.4 Million. The total expenses for the past year totaled approximately \$3.1 Million. The Committee is concerned with the new building proposed there will not be funds available for any additional operating personnel.

The BOS is to be commended for its action in 2007 to extend the retirement age and reduce the benefits paid at retirement. This action is a step in preserving the retirement fund and maintains the level of services provided to the taxpayers of Kern County. However, the BOS should not stop with this action as more measures are urgently needed to protect the retirement fund and the taxpayers of Kern County.

RECOMMENDATIONS:

KCERA

1. All employees of KCERA should be bonded with an "Employee Dishonesty Bond" to protect the organization from employee dishonesty.

2. Background checks should be performed for all employees (both full and part time).
3. Quarterly investment reports as well as potential county retirement funding contributions should be presented in public hearings before the Board of Supervisors.
4. KCERA should examine the feasibility of hiring an investment officer to advise the Board of Retirement as to potential risks of investment decisions as well as the appropriateness of the investments under consideration.
5. In order to encourage public participation and be informative the Retirement Board should make meeting information such as supporting documents as well as agendas available on the Associations web page.

BOARD OF SUPERVISORS

1. The Board of Supervisors working with other counties should work toward legislation to amend the 1937 Retirement Act to modify, for new employees, retirement benefits from a Defined Benefit Plan to a Defined Contribution Plan.
2. The County should discontinue the immediate 6% salary increase for new hires which encourages them to participate in the Deferred Compensation Plan (I.R.C 457). The County's matching of funds should be the sole incentive for participation in the plan.
3. The Board of Supervisors should establish a committee to review salary increases and new hires and the impact on pension contributions. This Committee should also be charged with recommending charges to the pension plan to protect its integrity and not over burden the taxpayer of Kern County.

The Kern County Employees' Retirement Association should post a copy of the report where it will be available for public review and should in their newsletter reference the web site where it can be found

Note: Present and past Kern County Grand Jury Final Reports and Responses can be accessed through the Kern County Law Library and on the Kern County Grand Jury website: www.co.ca.us/grandjury

Persons wishing to receive an email notification of newly released reports may sign up at www.co.kern.ca.us/grandjury, click on: Sign up for early releases.

RESPONSE REQUIRED WITHIN 90 DAYS TO:

**PRESIDING JUDGE
KERN COUNTY SUPERIOR COURT
1415 TRUXTUN AVENUE 2ND FLOOR
BAKERSFIELD, CA 93301**

**cc: FOREMAN
KERN COUNTY GRAND JURY
1415 TRUXTUN AVENUE, SUITE 600
BAKERSFIELD, CA 93301**

SOURCES AND REFERENCES

- **GRAND JURY REPORTS**

- 1997-1998 Kern County Grand Jury Report, *Kern County Retirement Association*
- 2009-2010 Fresno County Grand Jury Report, *Fresno County Employees Retirement Plan*
- 2006-2007 Ventura County Grand Jury Report, *Ventura County Employees' Retirement Plan*
- 2006-2007 Marin County Grand Jury Report, *Retiree health Care Costs*

- **2009 COUNTY RETIREMENT ACT OF 1937**

- **KERN COUNTY RETIREMENT ASSOCIATION DOCUMENTS**

- The Quarterly Publications of the kern County Retirement Association, January 2010
- The Comprehensive Annual Report for Fiscal Years Ended June 30, 2009 and 2008
- Actuarial Valuation June 30, 2009
- Space Needs Assessment and Analysis dated January 22, 2007, provided by American Realty Advisors
- Presentation to Board of Supervisors March 23, 2010, Recommended Contribution Rates for the Retirement System for Fiscal Year 2020-11
- Independent Review of Actuarial Valuation as of June 30, 2009 and Investigation of Experience (January 1, 2006-June 30, 2008) dated February 8, 2010
- Bylaws and Regulations Board of Retirement, dated December 10, 2008
- Investment Goals, Objectives and Policies, dated April 8, 2009
- Business plan 2009-10
- 2008 Governance Report, dated August 2009
- Management Letters from Brown Armstrong C.P.A.'s for Years ended June 30, 2006, 07, 08,09
- Board of Retirement Trustee Forms 700 for 2007-2008
- Investment Performance 2005-2006
- Summaries of KCERA Board Meeting Minutes 2005-09
- Building Project Notes
- Budget Information 2008-10
- Consultant Contracts with Investment Advisors, C.P.A.'s and Wilshire Advisors

NEWSPAPERS ARTICLES

- Bakersfield Californian. May 4, 2009, “Bad Advice Cost Pension Fund”,
By Steven Mayer
- Bakersfield Californian, Sept. 3, 2009, “County Pension Plan takes big
Hit”, by James Burger

- Bakersfield Californian, Dec. 16, 2009, County Retirement Liability Tops
\$1Billion” by James Burger
- Bakersfield Californian, Feb. 24, 2010, Cash-Strapped County won’t get
help from Retirement Board”, by James Burger
- Fresno Bee, March 23, 2010, “Fresno Co. gets one-two punch on budget
crisis” by Bran Branan